UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
JOHN THOMAS CAPITAL MANAGMENT GROUP LLC d/b/a PATRIOT28 LLC,	:	File No. 3-15255
GEORGE R. JARKESY, JR.,	:	
JOHN THOMAS FINANCIAL, INC., and	:	
ANASTASIOS "TOMMY" BELESIS,	:	
Respondents.	:	

RESPONDENTS' BRIEF AS REQUESTED BY AUGUST 3, 2015, COMMISSION ORDER REQUESTING ADDITIONAL BRIEFING

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Respondents John Thomas Capital Management LLC d/b/a Patriot28 LLC ("JTCM") and George R. Jarkesy, Jr. ("Jarkesy") (collectively "Respondents"), submit this Supplemental Brief as requested by the Commission in its Order dated August 3, 2015, and show the following:

INTRODUCTION

On May 11, 2015, in an unrelated case, *Tilton v. SEC*, No. 15-cv-2472(RA), the Division of Enforcement disclosed, for the first time ever, that the SEC Commissioners did not appoint Administrative Law Judge Carol Fox Foelak ("ALJ Foelak"). Subsequently, on June 30, 2015, Respondents filed their motion requesting discovery and additional briefing pertaining to constitutional considerations regarding the appointment of ALJ Foelak. Shortly thereafter, on August 3, 2015, the Commission issued an order granting the Motion in part, and requesting briefing on three discrete issues: (1) whether the Commission's ALJs are inferior officers within the meaning of the Appointments Clause; (2) whether their manner of appointment violates the Appointments Clause; and (3) the appropriate remedy if such violation is found.

In response to the Commission's request for additional briefing, Respondents hereby submit arguments and authorities demonstrating that (1) SEC ALJs are indeed "inferior officers;" (2) their manner of appointment does violate the Constitution; and (3) the appropriate remedy is dismissal of the administrative proceeding against Respondents.

ARGUMENT AND AUTHORITIES

A. SEC Administrative Law Judges Are "Inferior Officers" Within the Meaning of the Appointments Clause of the United States Constitution.

1. SEC ALJs Wield Significant Authority Qualifying Them as Inferior Officers.

> "[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 [Article II]."

Freytag v. C.I.R., 501 U.S. 868, 881 (1991) *quoting Buckley v. Valeo*, 424 U.S. 1, 126 (1976). The question thus presented is whether SEC ALJs exercise authority of such significance to render them more than "lesser functionaries" or employees. *Id.*

In *Freytag*, the Supreme Court evaluated whether Special Trial Judges ("STJs") appointed by the Tax Court were inferior officers of the United States or mere employees. In concluding that special trial judges were inferior officers, the Court noted that the "office was established by law" with "the duties, salary, and means of appointment for that office ... specified by statute." *Id.* Additionally, the Court focused on the "significance of the duties and the discretion" of the special trial judges, including the functions of taking testimony, conducting trials, ruling on the admissibility of evidence, enforcement of discovery orders, and the discretion employed by the STJs in performing such functions. *Id.* at 881-82.

SEC ALJs are identical to the tax court STJs in all material respects. First, SEC ALJs are "established by law." *See* 5 U.S.C. § 3105 ("[e]ach agency shall appoint as many administrative law judges as are necessary for proceedings required to be conducted..."). Federal regulation establishes the "Office of Administrative Law Judges" at the SEC, and the SEC is authorized by statute to delegate *any* of its functions to SEC ALJs. *See* 17 C.F.R. §§ 200.14, 200.30-9, 201.111; 15 U.S.C. §78d-1(a); *Hill v. SEC*, --- F. Supp. 3d ----, 2015 WL 4307088, at *3-4 (N.D. Ga. June 8, 2015). Additionally, SEC ALJ salaries are governed by statute. *See* 5 U.S.C. § 5372.

SEC ALJs, like the STJs evaluated in *Freytag*, "perform more than ministerial tasks." With regard to an SEC ALJ, SEC regulation confer adjudicatory authority as broad as allowed under statutory law. *See* 17 C.F.R. § 201.111. SEC ALJs are responsible for the "fair and orderly conduct of [administrative] proceedings," and have the specific authority to, among other

things: (1) administer oaths; (2) issue, revoke, quash, and/or modify subpoenas; (3) rule on the admission of evidence and offers of proof; (4) examine witnesses; (5) regulate administrative proceedings and the conduct of counsel and parties in such proceedings; (6) hold prehearing conferences; (7) recuse themselves; (8) rule on motions; (9) prepare initial decisions; and (10) under certain circumstances, reopen proceedings. 17 C.F.R. §§ 200.14, 201.111; *see also* 17 C.F.R. § 200.30-9; *Hill*, 2015 WL 4307088 at *17 ("The Court finds that like the STJs in *Freytag*, SEC ALJs exercise 'significant authority.'... 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)").

SEC ALJ's are virtually indistinguishable from the tax court STJs evaluated in *Freytag*. *See Freytag*, 501 U.S. at 910 (Scalia, J., concurring in part and concurring in judgment) (noting that all ALJs are "*executive* officers.") (emphasis in original); *see also Hill*, 2015 WL 4307088 at * 3-4; 16-19 ("The Court finds that based upon the Supreme Court's holding in *Freytag*, SEC ALJs are inferior officers"); *Duka v. SEC*, ---F. Supp. 3d----, 2015 WL 1943245, at *8 (S.D.N.Y. Apr. 15, 2015) ("The Supreme Court's decision in *Freytag v. Commissioner*, 501 U.S. 868, 111 (1991)... would appear to support the conclusion that SEC ALJs are also inferior officers").[1]

2. The Division's Past Arguments that SEC ALJs Are Not Inferior Officers, But Mere Employees, Are Unavailing.

The Division will presumably raise the same arguments it has made in previous Appointments Clause cases, which are as follows: (1) the decision in *Landry v. FDIC*, 204 F.3d

[1] *See also* Kent Barnett, Resolving the ALJ Quandary, 66 Vand. L. Rev. 797, 812 (2013) (the Supreme "Court has held that 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 are inferior officers") (citing Free Enterprise, 561 U.S. at 540 (Breyer, J., dissenting) (citing cases).

1125 (D.C. Cir. 2000), requires a finding that SEC ALJs are not "inferior officers" under the Appointments Clause, because SEC ALJs lack final decision authority and certain contempt powers; (2) the SEC has discretion on how and when to use its ALJ's; and (3) the Commission should defer to Congress's supposed determination that ALJ's are employees rather than inferior officers. Each of these arguments has been previously rejected for lacking merit.[2]

a. *Landry* Does Not Require a Finding that SEC ALJ's Are Mere Employees.

There is little doubt that the Division will rely on *Landry* as the cornerstone for its argument that SEC ALJs are employees and not inferior officers. The divided *Landry* court evaluated whether ALJs utilized by the Federal Deposit Insurance Corporation were "inferior officers" for the purposes of an Appointments Clause challenge. 204 F.3d 1125, 1134 (D.C. Cir. 2000). The *Landry* majority found the FDIC ALJs met many of the criteria discussed in *Freytag*, including that they 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 discovery compliance. *Id.* at 1133-34; *Hill*, 2015 WL 4307088 at * 18. The only distinctions drawn by the majority between the FDIC ALJs and the Tax Court STJs were that (1) the ALJs could not make final decisions, whereas the STJs could, in very limited instances, make binding final orders; and (2) the Tax Court was required to give deference to STJ factual findings, unless they were clearly erroneous, whereas the FDIC was not required to give such deference to the findings of its ALJs. *Id.* at 1133. Based on these distinctions, the *Landry* majority found the FDIC ALJs were not "inferior officers" within the meaning of the Appointments Clause. *Id.* at 1134.

[2] Due to the Commission's request for simultaneous briefs, instead of the normal procedure for filing a brief, then a response, and then a reply, Respondents are left to anticipate what, if any, arguments the Division will make as to why SEC ALJs are employees and not "inferior officers" under the Appointments Clause.

The *Landry* concurring opinion (as well as other recent district court opinions) takes issue with the majority's conclusion that the *Freytag* Court ultimately decided that the Tax Court STJs were inferior officers based primarily on the fact they had final decision making authority in limited cases. *See Id.* at 1142 (Randolph, J., concurring in part and concurring in judgment) ("What the majority neglects to mention is that the Court *clearly* designated [the holding pertaining to the STJ's decision making authority] *as an alternative holding*") (emphasis added)[3]; *see also id.* at 1140 ("The Administrative Law Judge who presided over Landry's case was as much an 'inferior officer' under Article II, § 2, cl. 2 of the Constitution as the special judge in *Freytag*."); *Hill*, 2015 WL 4307088 at * 18 (concluding as the concurrence in *Landry* that the *Freytag* decision did not rest on final decision making authority and that "the STJs powers—which are nearly identical to the SEC ALJs here—were independently sufficient to find that STJs were inferior officers.... 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

[3] The language at issue in *Freytag* is as follows:

> The Commissioner reasons that special trial judges may be deemed employees in subsection (b)(4) cases because they lack the authority to enter a final decision. But this argument ignores the significance of the duties and discretion that special trial judges possess. The office of special trial judge is "established by Law," Art. II, § 2, cl. 2, and the duties, salary, and means of appointment for that office are specified by statute. *See Burnap v. United States*, 252 U.S. 512, 516-17, 40 S.Ct. 374, 376-377, 64 L.Ed. 692 (1920); *United States v. Germaine*, 99 U.S. 508, 511-12, 25 L.Ed. 482 (1879). These characteristics distinguish special trial judges from special masters, who are hired by Article III courts on a temporary, episodic basis, whose positions are not established by law, and whose duties and functions are not delineated in statute. Furthermore, special trial judges perform more than ministerial tasks. They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. In the course of carrying out these important functions, the special trial judges exercise significant discretion.
>
> 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. Under §§ 7443A(b)(1), (2), and (3), and (c), the Chief Judge may assign special trial judges to render the decisions of the Tax Court in declaratory judgment proceedings and limited-amount tax cases.

Freytag, 501 U.S at 881 - 82.

orders was only an additional reason, not *the* reason") (emphasis in original) (citations omitted); Decision & Order in *Duka v. SEC*, 15 Civ. 357 (RMB)(SN), 2015 WL 4940057, at * 2 (S.D.N.Y. Aug. 3, 2015) ("The Court here concludes that SEC ALJs are "inferior officers" because they exercise "significant authority pursuant to the laws of the United States." *Freytag*, 501 U.S. at 881.... The Court is aware that *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000) is to the contrary"). It is very clear from the language in *Freytag* that the STJ's ability or inability to issue final order did not influence the Court's conclusion that the STJs were inferior officers; specifically the Court dispenses with the argument: "[t]he Commissioner reasons that special trial judges may be deemed employees ... because they lack the authority to enter a final decision. But this argument ignores the significance of the duties and discretion that special trial judges possess." *Freytag*, 501 U.S. at 881.

Further supporting this interpretation, *Freytag* cited *Samuels, Kramer & Co. v. C.I.R.*, 930 F.2d 975 (2d Cir. 1991), for the proposition that STJ's are inferior officers. *See Freytag*, 501 U.S. at 881 ("We agree with ... the Second Circuit [in *Samuels*] that a special trial judge is an 'inferior officer' whose appointment must conform to the Appointments Clause"). In *Samuels*, the Second Circuit Court of Appeals faced the same question at issue in *Freytag*—whether Tax Court STJs are inferior officers for the purposes of the Appointments Clause. The Second Circuit, specifically rejecting the argument that "inferior officers" must have decision-making authority, wrote:

> Although the ultimate decisional authority in cases under section 7443A(b)(4) rests with the Tax Court judges, the special trial judges do exercise a great deal of authority in such cases. The special trial judges are more than aids to the judges of the Tax Court. They take testimony, conduct trials, rule on the admissibility of evidence, and have other powers to enforce compliance with discovery orders. Contrary to the contentions of the Commissioner, the degree of authority exercised by special

> trial judges is "significant." They exercise a great deal of discretion and perform important functions, characteristics we find to be inconsistent with the classifications of "lesser functionary" or mere employee.

Samuels, 930 F.2d at 985-86. (citations omitted). The only way to reconcile the *Freytag* Court's agreement with *Samuels* is to read *Freytag's* holding as not requiring final decision-making authority to justify a finding of an "inferior officer."

Finally, the majority's reading of *Freytag* that final decision-making authority is dispositive of "inferior officer" status conflicts with other Supreme Court precedent; final decision-making authority is a characteristic of a "principal officer," not an "inferior officer." *See Edmond v. U.S.*, 520 U.S. 651, 665-666 (1997) (finding appointment of judges to the Coast Guard Court of Criminal Appeals by the Secretary of Transportation to comport with the Appointments Clause of the Constitution as such judges are "inferior officers" and not "principal officers" because "judges of the [Coast Guard] Court of Criminal Appeals have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers").

The Division's arguments to the contrary are disingenuous. Significantly the General Counsel's office has told the Supreme Court that that the inability to make a final decision qualifies one as an inferior *officer* of the SEC, rather than a principal officer, contrary to the Division's position in this matter. *See* Brief of the United States at *32, n. 10, *Free Enter. Fund v. Pub. Accounting Oversight Bd.*, 561 U.S. 477 (2010) (No. 08-861), 2009 WL 3290435, (the government argued "it is plain that" Public Accounting Oversight "Board members, unlike SEC Commissioners, are inferior officers" because of the ability of the SEC Commissioners to "reverse, veto, or set aside every enforcement decision the Board makes" and the "Board's members 'have no power to render a final decision on behalf of the United States unless

permitted to do so by other Executive Officers'"). The General Counsel explained that, "as *Edmond* makes clear, the inability to render a final decision on behalf of the Executive Branch unless 'permitted to do so by other Executive Officers' is itself indicative of inferior, not principal, officer status." *Id.* at * 31.

The only other difference mentioned by the majority in *Landry* between the FDIC ALJs and the STJs at issue in *Freytag* was that the Tax Court is required to give deference to certain findings of the Tax Court unless such findings were found to be clearly erroneous. *Landry*, 204 F.3d at 1133. As noted by Judge Randolph in his concurrence, the Supreme Court in *Freytag* specifically excluded this element under Tax Court Rule 183 when making its decision that STJs are inferior officers. *See id.* at 1141-42 (Randolph, J., concurring in part and concurring in judgment) ("the Supreme Court in *Freytag* decided that Tax Court Rule 183 and its deferential standard were 'not relevant to our grant of certiorari'—and the Court granted the writ, so it explained, in order 'to resolve the important questions the litigation raises about the Constitution's structural separation of powers.' The majority's first distinction of *Freytag* is no distinction at all") (citations omitted); *see also Hill*, 2015 WL 4307088 at * 18 (agreeing with the concurrence in *Landry* that "the Tax Court's deference to the STJ's credibility was irrelevant to [the Freytag Court's] analysis").

b. The Division's Other Arguments Made in the Past Do Not Support a Commission Finding that SEC ALJs Are Inferior Officers.

The Division's other arguments made in other cases in support of ALJ status as mere employee instead of inferior officer are equally unpersuasive. In the past, the Division has argued (1) the lack of contempt power means that ALJs are employees and not inferior officers;

and (2) that adjudicators should defer to Congressional intent that ALJs be employees and not inferior officers.[4]

An ALJ's lack of power to enforce a finding of contempt is not dispositive of an ALJs status as employee versus an inferior officer. The point was not deemed important in *Freytag* or *Samuels*; it was mentioned only by the *Freytag* Court for the determination that the Tax Court was an Article I court of law; it was not mentioned and certainly not determinative of the same Court's finding that STJs were inferior officers. *See Freytag*, 501 U.S. at 891. Additionally, an ALJ is not completely without the power to enforce its findings; as noted by Judge May in *Hill*, SEC ALJs may "issue sanctions, up to and including excluding people (including attorneys) from hearings and entering default." *See Hill*, 2015 WL 4307088 at * 17. Further, as Judge May noted in a more recent decision, *Timbervest, LLC v. SEC*, No. 1:15-cv-2106-LMM (N.D. Ga. Aug. 4, 2015) ("*Timbervest*"), where the Commissioners as principal officers themselves do not hold the particular power, a subordinate party lacking the same power will not be disqualified from being considered an inferior officer. In this case, the Commissioners, as principal officers, do not have the authority to enforce contempt orders (or issue injunctions) without going to a district court; that SEC ALJs lack those same powers is a "distinction without a difference" and does not evidence that SEC ALJs are employees and not inferior officers. *See Timbervest*, at * 24-25.

The Division's position that adjudicators should defer to presumed Congressional intent that ALJs are employees and not inferior officers is equally unavailing. First, there is no evidence that Congress intended ALJs to be employees; to the contrary, in several laws, ALJs are

[4] In recent filings the Division has advanced different arguments why SEC ALJs should be considered employees and not inferior officers. With respect to the briefing format that the Commission requested (simultaneous submission of briefs) Respondents cannot guess all the arguments the Division will make as to why SEC ALJs are not inferior officers. To the extent the Commission declines to request additional response briefing, Respondents would point the Commission to the recent orders issued in *Hill*, *Timbervest*, and *Gray Fin. Grp. v. SEC*, No. 1:15-cv-0492-LMM, Dkt. 56 (N.D. Ga. Aug. 4, 2015) which specifically address each of the arguments advanced thus far by the Division and conclude that SEC ALJs are "inferior officers" under the Appointments Clause.

referenced as distinct from employees. *See* 5 U.S.C. § 4301(2)(d) (exempting ALJs from the definition of "employee"); 15 U.S.C. § 78d-1(a) (the SEC may delegate certain of its functions to a Commissioner, a division of the Commission, an ALJ, and employee or a board of employees).

Additionally, the purpose of the Appointments Clause is to check Congress from becoming lax in its delegation of authority; put another way, the Appointments Clause exists so that Congressional intent could not erode the separation of powers by intending the position to be an "employee," but conferring the powers of an inferior officer or principal officer. *See Hill*, 2015 WL 4307088 at * 19 ("'[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. 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").

B. Judge Foelak's Appointment Violates the Appointments Clause of the United States Constitution.

The Appointments Clause in Article II of the Constitution states that "Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. CONST. art II, § 2, cl. 2. The Appointments Clause is the exclusive manner in which inferior officers may be appointed. *See Freytag*, 501 U.S. at 881; *Buckley*, 424 U.S. at 138-39. The SEC is considered a "Department" under the appointments clause and the Commissioners collectively function as the "Head" of the Department. *See Free Enter. Fund v. Pub. Accounting Oversight Bd.*, 561 U.S. 477 (2010).

Per *Buckley*, if SEC ALJs are "inferior officers," they must either be appointed by the President, a Court of Law, or the Commission. ALJ Foelak was not appointed by the President, a Court of Law, or the Commission, in violation of the Appointments Clause. *See Hill*, 2015 WL

4307088 at * 3 ("SEC ALJs are not appointed by the President, the Courts, or the [SEC] Commissioners. Instead, they are hired by the SEC's Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resource functions, and the Office of Personnel Management) (internal citations omitted); 5 C.F.R. § 930.204 ("An agency may appoint an individual to an administrative law judge position only with prior approval of OPM, except when it makes its selection from the list of eligibles provided by OPM. An administrative law judge receives a career appointment and is exempt from the probationary period requirements under part 315 of this chapter"); Transcript of Temporary Injunction Hearing at 26, *Tilton v. SEC*, No. 15-cv-2472(RA) (S.D.N.Y. May 11, 2015) ("we acknowledge that the commissioners were not the ones who appointed ... ALJ Foelak").[5]

C. These Constitutional Violations Render the Administrative Proceeding Before ALJ Foelak Void.

1. The Underlying Administrative Proceeding Is Void.

"The roots of the separation-of-powers concept embedded in the Appointments Clause are structural and political." *Freytag*, 501 U.S. at 878. The Appointments Clause "is a bulwark against one branch aggrandizing its power at the expense of another branch, but it is more: it 'preserves another aspect of the Constitution's structural integrity by preventing the diffusion of the appointment power." *Ryder v. U.S.*, 515 U.S. 177, 182 (1995) quoting *Freytag*, 501 U.S at 878. "The structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic." *Freytag*, 501 U.S. at 878. "[O]ne who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates

[5] By Order of the Commission dated August 3, 2015, the Temporary Injunction order issued in *Hill* and the transcript of the temporary injunction hearing in *Tilton* are already part of the record. Additionally, Respondents requested discovery, by way of their June 30, 2015 Motion to Adduce Additional Evidence and Conduct Further Discovery, pertaining to the exact process by which ALJ Foelak was appointed, which motion remains pending before the Commission.

his case is entitled to a decision on the merits of the question and whatever relief may be appropriate if a violation indeed occurred. Any other rule would create a disincentive to raise Appointments Clause challenges with respect to ... appointments." *Ryder*, 515 U.S. at 182-83. A party is not required to show direct injury for entitlement to Appointment Clause remedy. *Landry*, 204 F.3d at 1130 ("But the Court uses the term 'structural' for a set of errors for which no direct injury is necessary"). Respondents' challenge to the constitutional validity of ALJ Foelak's appointment was timely. The disclosure by the Division in *Tilton v. SEC*, No. 15-cv-2472(RA), on May 11, 2015—overcoming the presumption of regularity of agency proceedings—provided the very first indication that ALJ Foelak's appointment was unconstitutional. Respondents' challenge, like the Division's remarkable disclosure, came after the merits hearing conducted by ALJ Foelak and after subsequent briefing before the Commission, but still during the pendency of Respondents' administrative proceeding.

The only appropriate remedy for such a constitutional violation is to render the underlying proceeding void. *See Ryder*, 515 U.S. at 188 (reversing decision of judge appointed in violation of the Appointments Clause because "[p]etitioner is entitled to a hearing before a properly appointed panel of [the] court"); *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 684 F.3d 1332 (D.C. Cir. 2012) (vacated determinations of judges appointed in violation of the Appointments Clause); *see also Landry*, 204 F.3d at 1131 ("The [Supreme] Court recently noted its use of the label 'structural,' observing that only in a limited class of cases has it 'found an error to be "structural," and thus subject to *automatic* reversal") (quoting *Neder v. United States*, 119 S. Ct. 1827, 1833 (1999)) (emphasis added); *Id.* at 1132 ("a defect in appointment of an 'examiner' (precursor of today's ALJ) was, if properly raised, 'an irregularity which would invalidate a resulting order'") (quoting *United States v. L.A. Tucker Truck Lines*, 344 U.S. 33, 38

(1952)). As noted in *Freytag*, "[t]he alleged defect in the appointment ... goes to the validity of the ... proceeding that is the basis for this litigation." 501 U.S. at 879. Without such a remedy, there is no incentive to make an Appointments Clause challenge.

2. Commission "*De Novo*" Review Does Not Render the Constitutional Violation Harmless.

While often described as a "*de novo*" review, the Commission's review would not provide the type of review that would or could remedy such a structural constitutional error. The Commission's review is not truly *de novo*; it defers to the ALJ for certain critical matters including credibility determinations and evidentiary rulings—both of which played a significant role in the underlying administrative proceeding in this matter. *See Hill*, 2015 WL 4307088 at * 3 ("the SEC will accept the ALJ's 'credibility finding, absent overwhelming evidence to the contrary'") (citing *In re Clawson*, Exch. Act Rel. No. 48143, 2003 WL 21539920, at *2 (July 9, 2003); *see also In re Pelosi*, Sec. Act Rel. No. 3805, 2014 WL 1247415, at *2 (Mar. 27, 2014) ("The Commission gives considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor. Such determinations can be overcome only where the record contains substantial evidence for doing so") (citations and quotations omitted); *see also Ryder*, 515 U.S. at 187-88 (vacation of underlying decision appropriate where reviewing court does not give the party "all the possibility of relief" as underlying court). In particular, an improperly appointed ALJ Foelak made the determination that Respondents' key witness, Mr. Jarkesy, "did not provide any assurances of the reliability of his testimony," and based on that credibility determination held that "no weight has been placed on his testimony as to facts that are disputed or not corroborated by credible

evidence elsewhere in the record."[6] *See* Initial Decision at p. 10. Additionally, the unconstitutionally-appointed ALJ Foelak made key evidentiary decisions—usually allowing the Division's proffered evidence over objection and excluding Respondents' evidence. *See* Respondent's Opening Br. at pps. 35-38; Respondents' Additional Submission of Feb. 13, 2005.

Further, even if the Commission's review was truly *de novo*, it would not operate to save the decision of an ALJ appointed in violation of the Appointments Clause. This argument was explicitly addressed by the *Landry* court, which found such a rule would effectively trivialize the Appointments Clause. *See Landry*, 204 F.3d at 1132 ("If the process of final *de novo* review could cleanse the violation of its harmful impact, then all such arrangements would escape judicial review... [r]ecognition of this problem may well explain the [Supreme] Court's statement in *United States v. L.A. Tucker Truck Lines* that a defect in the appointment of an 'examiner' (precursor of today's ALJ) was, if properly raised, 'an irregularity which would invalidate a resulting order'") (quoting *United States v. L.A. Tucker Truck Lines*, 344 U.S. 33 (1952)). Other cases have reached the same conclusion.

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[6] It is noteworthy here that the Commission actually played a role in this finding. The Division, with the help of Commissioners, effectively removed any corroboration to Mr. Jarkesy's testimony. Though the Division asserted that the mastermind behind the allegations contained in the OIP was Tommy Belesis (who was registered with and subject to the rules and regulations of the SEC), before Respondent's hearing the Division offered, and the Commission accepted, a settlement with Mr. Belesis, which resulted in a recoupment of a minor fraction of the damages the Division seeks from Respondents. As a part of that settlement, the Division, with the blessing of the Commission, precluded Mr. Belesis from testifying as to the truth, threatening Mr. Belesis that if he offered any testimony in contradiction of any of the allegations contained in his agreement, whether the truth or not—none of which was he required to admit to—the Division would rescind the settlement and Mr. Belesis would face damages and penalties multiple times larger than what was contained in his settlement. Here, in an effort to win rather than uncover the truth, the Division, along with the Commission, has effectively railroaded Respondents by depriving them of corroborating evidence.

This is in stark contrast to other settlement agreements that (1) either require a Respondent to allocute or (2) require a Respondent to testify. In both of those situations, the person accepting the plea, under oath, testifies to the "truth" under the penalty of perjury. In this instance, making Mr. Belesis "an offer he couldn't refuse," the Division did not require consent to or admission of the factual findings contained within the settlement agreement, but effectively precluded Mr. Belesis from testifying at Respondents' hearing as to the truth.

In *Intercollegiate Broadcast Systems, Inc. v. Copyright Royalty Board*, the D.C. Circuit invalidated certain decisions by Copyright Royalty Judges because they were improperly appointed pursuant to the Appointments Clause. 684 F.3d 1332 (D.C. Cir. 2012) ("Because of the Appointments Clause violation at the time of the decision, we vacate and remand the determination challenged here"). In *Ryder v. United States*, Ryder challenged the Coast Guard Court of Military Review as violating the Appointments Clause. *Ryder*, 515 U.S. 179. The government made the argument that *de novo* review by a higher court invalidated the claim. *Id.* at 186-88. The Supreme Court, in dispensing with the argument, found that the higher court served a different function and had different authority than the lower court and that Ryder had been "entitled to a hearing before a properly appointed panel." *Id.* at 188.

CONCLUSION

The Appointments Clause of the United States Constitution stands as a bulwark enforcing the separation-of-powers for the branches of our Government. There is no question that SEC ALJs are "inferior officers" for the purposes of Appointment Clause analysis—to find otherwise would be to go against the great weight of authority established by the Supreme Court—not to mention the position staked out by the Commission's own General Counsel's office. Additionally, there is no question that ALJ Foelak was not appointed in the manner specified by the Appointments Clause; that is by the President of the United States, by the judiciary, or by a head of the relevant executive department, to wit: the Commission. As such, the initial decision, as well as all evidentiary and credibility determinations made by Judge Foelak, are void and without effect, leaving the Commission with no constitutionally or statutorily valid Initial Decision to review. The administrative proceeding against Respondents must be dismissed.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on August 28, 2015, the foregoing document was served on the parties below and in the manner indicated.

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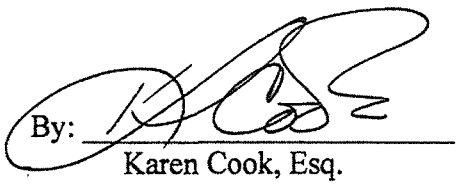

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