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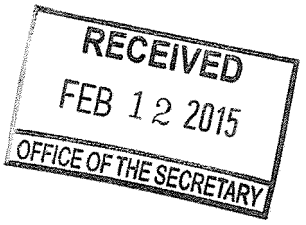

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15519

In the Matter of	:
Timbervest, LLC,	:
Joel Barth Shapiro,	:
Walter William Anthony Boden, III,	:
Donald David Zell, Jr.,	:
and Gordon Jones II,	:
Respondents.	:

DIVISION OF ENFORCEMENT'S MEMORANDUM OF LAW IN RESPONSE TO THE COMMISSION'S ORDER REQUESTING SUPPLEMENTAL BRIEFING

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The Division of Enforcement respectfully submits this Memorandum of Law in response to the Commission's January 20, 2015 order requesting supplemental briefing on Respondents' argument that the "administrative process is unconstitutional because SEC [administrative law judges ("ALJs")] are executive officers who enjoy two-tiered tenure protection." Order Regarding Supplemental Briefing (Jan. 20, 2015) (quoting Respondent Timbervest's Opening Br. at 38-39 ("Br.")); *see also* Revised Order Regarding Supplemental Briefs (Feb. 2, 2015).

For the reasons set forth below, Commission administrative proceedings do not violate Article II of the Constitution. Commission ALJs are not constitutional officers—the only Court of Appeals to have considered the status of an agency's ALJs concluded they are employees, *see Landry v. FDIC*, 204 F.3d 1125, 1132-34 (D.C. Cir. 2002)—and therefore the removal framework applicable to them does not implicate Article II. And even if Commission ALJs were constitutional officers, the President exercises adequate control to satisfy the Constitution.

Accordingly, Respondents' argument should be rejected.

BACKGROUND

I. Statutory and Regulatory Framework

A. Commission ALJs

Pursuant to statute, the SEC may appoint ALJs to conduct hearings in administrative proceedings instituted by the Commission. 5 U.S.C. § 3105 (providing that "[e]ach agency shall appoint as many administrative law judges as are necessary for [administrative] proceedings"); *see also* 17 C.F.R. § 200.14(a). However, no statute requires the SEC to use ALJs. The Commission determines whether to hold a hearing in a given administrative proceeding and, if so, whether to have an ALJ preside over the hearing. *Id.* §§ 201.110, 201.300. At the conclusion of any proceeding in which an ALJ presides, the ALJ prepares an "initial decision," *id.* § 201.360(a)(1), which a respondent or the Division of Enforcement may appeal to the Commission, *id.* § 201.410, or which the Commission may review "on its own initiative," *id.* § 201.411(c). If a respondent does not appeal and if the Commission does not initiate review on its own, "the Commission will issue an order" making the ALJ's initial "decision . . . final" as

to that respondent. *Id.* § 201.360(d)(2). The Commission's review of the ALJ's initial decision is *de novo*, *id.* §§ 201.411(a), 201.452, and only the Commission can issue the final decision of the agency. If a majority of participating Commissioners does not agree to a disposition, the ALJ's "initial decision shall be of no effect, and an order will be issued [by the Commission] in accordance with this result." *Id.* § 201.411(f).

The SEC has used ALJs since the Commission's early days.[1] The SEC's enabling statute conferred on the SEC the discretion to use ALJs: the SEC may delegate, by published order or rule, "any of its functions" to an ALJ but "retain[s] a discretionary right to review" any functions delegated to ALJs. 15 U.S.C. § 78d-1(a), (b). SEC ALJs are responsible for the fair and orderly conduct of the initial stages of those proceedings for which they are designated to serve as hearing officers. *See* 17 C.F.R. §§ 200.14(a), 201.101(a)(5). They are subject to supervision and are subordinate to the Commission on questions of policy and interpretation of law. *See, e.g.*, *Nash v. Bowen*, 869 F.2d 675, 680 (2d Cir. 1989); *Auth. of Educ. Dep't Admin. Law Judges in Conducting Hearings*, 14 Op. O.L.C. 1, 2 (1990).

B. The ALJ Position Within the Competitive Service

At the SEC, as throughout the federal government, ALJs are civil service employees in the "competitive service" system. 5 C.F.R. § 930.201. The competitive service is the most basic category within the civil service; it includes positions such as corrections officers, human resources specialists, and paralegals. *See* 5 U.S.C. § 2102; 5 C.F.R. § 212.101.[2]

The Civil Service Reform Act of 1978 (the "CSRA"), 5 U.S.C. §§ 1101 *et seq.*, governs federal civil-service employment, including SEC ALJs' employment. *See, e.g.*, *Mahoney v.*

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[1] For examples of the early use of ALJs by the SEC, *see Charles Hughes & Co. v. SEC*, 139 F.2d 434 (2d Cir. 1943), and *Okin v. SEC*, 143 F.2d 960 (2d Cir. 1944); *see also* Daniel J. Gifford, *Federal Administrative Law Judges: The Relevance of Past Choices to Future Directions*, 49 Admin. L. Rev. 1, 4-6, 9 n.39 (1997).

[2] Other categories within the civil service include the "excepted service," in which some positions such as attorneys are excepted from competitive service, 5 U.S.C. § 2103, and the "Senior Executive Service," in which positions involving senior managers are placed, *id.* § 3132.

Donovan, 721 F.3d 633, 635 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 2724 (2014). The CSRA regulates SEC ALJs' employment as it does that of other federal employees by, *inter alia*: setting merit systems principles to guide agency personnel management, 5 U.S.C. § 2301; describing numerous bases on which personnel actions against employees, including ALJs, are prohibited, *id.* § 2302; and specifying the administrative and judicial remedies available in response to such prohibited personnel practices, *id.* §§ 1204, 1212, 1214, 1215, 1221. The U.S. Office of Personnel Management ("OPM"), which oversees federal employment for ALJs as it does for other rank-and-file civil servants, administers a detailed civil service system for selecting ALJs, including conducting examinations for ALJ candidates, *see id.* §§ 1104, 1302; 5 C.F.R. §§ 930.201(d)-(e), 930.203; ranking ALJ applicants for placement on a register of eligible candidates according to their qualifications and numerical ratings, 5 U.S.C. § 3313; 5 C.F.R. § 332.401; and issuing "certificates of eligibles" from which federal agencies—including the SEC—may select individuals to fill ALJ vacancies, 5 U.S.C. §§ 3317, 3318; 5 C.F.R. §§ 332.402, 332.404. OPM oversees each agency's "decisions concerning the appointment, pay, and tenure" of ALJs, *id.* § 930.201(e)(2), and establishes classification and qualification standards for the ALJ positions, *id.* § 930.201(e)(3). Like other appointments in the competitive service, appointment as an SEC ALJ is subject to an investigation and adjudication of suitability under OPM's suitability requirements. *Id.* § 930.204(a); *id.* §§ 731.101 *et seq*.

Employees (including SEC ALJs) who believe their employing agencies have engaged in a prohibited personnel practice can seek redress either through the Office of Special Counsel ("OSC") or the Merit Systems Protection Board ("MSPB"). *See* 5 U.S.C. §§ 1204, 1212, 1214, 1215, 1221. Pursuant to statute, "the agency in which [an] administrative law judge is employed" may propose certain specified personnel actions (*i.e.*, removal, suspension, reduction in grade, reduction in pay, or a furlough of 30 days or less) against an ALJ. *Id.* § 7521; 5 C.F.R. §§ 930.211, 1201.137. The employing agency initiates the proceedings, which include an opportunity for a hearing before the MSPB. 5 U.S.C. § 7521; 5 C.F.R. § 1201.139. The MSPB then decides whether "good cause" exists to take the proposed personnel action, such as removal,

against the ALJ. 5 U.S.C. § 7521(a). Finally, SEC ALJs—again like other employees—are subject to agency reductions-in-force. *Id.* § 7521(b); 5 C.F.R. § 930.210.

ARGUMENT

I. SEC ALJs Are Employees, Not Inferior Officers of the United States

Respondents argue that the removal scheme governing SEC ALJs violates Article II of the Constitution. SEC ALJs, however, are employees, not constitutional officers, and thus the President's alleged lack of power to remove them does not implicate Article II.

The Appointments Clause provides that the President shall appoint all "*Officers* of the United States," whose Appointments are not otherwise provided for in the Clause, "but the 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 (emphasis added). The power to appoint encompasses the power to remove, *Myers v. United States*, 272 U.S. 52, 161 (1926); *In re Hennen*, 38 U.S. 230, 254-55 (1839), but the Appointments Clause does not speak to the power to either appoint or remove *employees* who do not rise to the level of officers of the United States. *See Buckley v. Valeo*, 424 U.S. 1, 126 n.162 (1976); *Tucker v. Comm'r*, 676 F.3d 1129, 1132 (D.C. Cir. 2012). The Supreme Court has long recognized that the vast majority of government personnel are "employees," that is, "lesser functionaries subordinate to officers of the United States." *Buckley*, 424 U.S. at 126 & n.162; *see Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477, 506 n.9 (2010); *United States v. Germaine*, 99 U.S. 508, 509 (1878).

The Supreme Court has said that whether incumbents are classified as officers or employees is determined by "the manner in which Congress has specifically provided for the creation of the . . . positions, their duties and appointment thereto." *Burnap v. United States*, 252 U.S. 512, 516 (1920); *see also Freytag v. Comm'r*, 501 U.S. 868, 881 (1991) (considering "the duties, salary, and means of appointment for th[e] office" of special trial judge of the United States Tax Court in determining whether special trial judges were officers or employees (citing

Burnap, 252 U.S. at 516-17; *Germaine*, 99 U.S. at 511-12)). The Court has also held that to be an "Officer of the United States," a person must "exercis[e] significant authority pursuant to the laws of the United States." *Buckley*, 424 U.S. at 125-26.

As discussed below, the SEC's discretion whether and how to use ALJs, the ALJs' role within the SEC's decision-making scheme, and the history of the ALJ system, including Congress's placement of the position within the competitive service system, all reflect that SEC ALJs are "mere aids" to the SEC and not officers exercising "'significant authority,'" *Samuels, Kramer & Co. v. Comm'r*, 930 F.2d 975, 985-86 (2d Cir. 1991) (quoting *Buckley*, 424 U.S. at 126), and that Congress intended ALJs to be employees—a judgment that is entitled to significant deference. Indeed, the one Court of Appeals to have directly addressed this question concluded that ALJs are employees. *Landry*, 204 F.3d at 1132-34.

A. SEC ALJs Have Only the Authority the SEC Decides to Delegate to Them and Do Not Have the Requisite "Significant Authority" to be Inferior Officers

That SEC ALJs are "lesser functionaries subordinate to officers of the United States," *Buckley*, 424 U.S. at 126 n.162, is evident in that Congress has not mandated that the SEC use ALJs at all. As set forth by statute, the SEC can decide to appoint as many ALJs as warranted, 5 U.S.C. § 3105, and has the authority to decide what functions it wishes to delegate to those ALJs, 15 U.S.C. § 78d-1. Congress has not required the SEC to use its ALJs to conduct its administrative proceedings. SEC regulations provide that a "[h]earing officer" can be an ALJ, "a panel of Commissioners constituting less than a quorum of the Commission, an individual Commissioner, or any other person duly authorized to preside at a hearing." 17 C.F.R. § 201.101(a)(5). If the Commission decides to initiate an administrative proceeding, the Commission also determines whether the hearing officer will be an ALJ; if so, the Chief ALJ selects which of the SEC ALJs will preside. *Id.* § 201.110. Only then would the selected ALJ have the authorities of a hearing officer, as set forth in SEC regulations. *Id.* § 201.111. And, the

SEC retains plenary authority to review any functions that it decides to delegate to ALJs. 15 U.S.C. § 78d-1(b).

Moreover, SEC ALJs only have a preliminary role within the SEC's decision-making scheme: they have only the power to make initial decisions. During the administrative process, "the Commission may, at any time, on its own motion, direct that any matter be submitted to it for review." 17 C.F.R. § 201.400(a). An ALJ serving as a hearing officer prepares only an "initial decision." *Id.* § 201.360(a)(1). If no further review is sought or otherwise ordered by the Commission on its own, then the Commission issues an order of finality, specifying the date on which sanctions, if any, take effect. *Id.* § 201.360(d). If the Commission grants the petition for review or otherwise decides to review the ALJ's initial decision, its review is *de novo*. *See id.* § 201.411(a); *see, e.g.*, *Gregory M. Dearlove, CPA,* Exchange Act Release No. 57244, 2008 WL 281105, at *10 n.42 (Jan. 31, 2008) ("The law judge's opinion ceased to have any force or effect once [petitioner] filed his petition for review."). The Commission "may affirm, reverse, modify, [or] set aside" the initial decision, "in whole or in part," and it "may make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. § 201.411(a). The Commission may also "remand for further proceedings," *id.*, "remand . . . for the taking of additional evidence," or "hear additional evidence" itself. *Id.* § 201.452; *see also Nash*, 869 F.2d at 680 (under the Administrative Procedure Act ("APA"), in reviewing an ALJ's initial decision the agency "retains 'all the powers which it would have in making the initial decision'" (quoting 5 U.S.C. § 557(b))). That the ALJ's decision is only preliminary is evident in that "[i]n the event a majority of participating Commissioners do not agree to a disposition on the merits," the regulations specify that the ALJ's "initial decision shall be of no effect." *Id.* § 201.411(f).

The D.C. Circuit's decision in *Landry*, 204 F.3d at 1133-34, is directly on point. There, an ALJ of the Federal Deposit Insurance Corporation ("FDIC") had recommended, following a hearing, that a bank officer be removed from his position and barred from working in a federally insured depository institution. *Id.* at 1128. The FDIC Board of Directors accepted the ALJ's

recommendation and issued an order of removal and prohibition. *Id.* The bank officer then petitioned for review of the FDIC's final order in the court of appeals and argued that the FDIC's method of appointing ALJs violated the Appointments Clause. *Id.* The D.C. Circuit found no Appointments Clause violation because FDIC ALJs are employees, not constitutional officers. *Id.* at 1133. The D.C. Circuit reasoned that FDIC ALJs do not have enough authority to make them inferior officers because they "can never render the decision of the FDIC." *Id.* Instead, "[f]inal decisions are issued only by the FDIC Board of Directors." *Id.* Similarly here, SEC ALJs do not have final decision-making authority. Their adjudications represent only the first step of the agency's decision-making process, and only the Commission has the authority to issue the agency's final decision. Thus, under the reasoning of *Landry*, SEC ALJs are not inferior officers.

Respondents cite (Br. at 38) to *Freytag v. Commissioner*, which held that special trial judges of the Tax Court are inferior officers. 501 U.S. at 880. *Freytag*, however, does not control because as the D.C. Circuit found in *Landry*, ALJs are distinguishable from special trial judges. 204 F.3d at 1133-34.[3] Although the *Landry* court recognized that there are similarities between special trial judges and FDIC ALJs, *id.*, it concluded that the former's ability to issue final decisions in certain categories of cases "was critical to the [*Freytag*] Court's decision" that they are inferior officers, *id.* at 1334. Indeed, in *Freytag*, the Commissioner of the Internal Revenue Service had conceded that special trial judges "act as inferior officers who exercise independent authority" for certain categories of the cases. 501 U.S. at 882. The *Freytag* court observed that "[s]pecial trial judges are not inferior officers for purposes of some of their duties . . . but mere employees with respect to other responsibilities." *Id.* The D.C. Circuit in *Landry* also noted that unlike FDIC ALJs, special trial judges have significant discretion in cases over which they do not have final decision-making authority, including, for example, that the Tax Court was

[3] Clearly, not all judges at any level within any constitutional, statutory, or regulatory scheme possess the same stature or exercise the same powers. Just as having the final decision-making authority on behalf of an Executive Branch agency would not necessarily be sufficient to render a government employee an inferior officer, *see, e.g.*, *Tucker*, 676 F.3d at 1133, whether a particular kind of judge is an inferior officer similarly does not rise or fall on whether he or she is nominally referred to as a "judge" and performs, in the most general sense, the same kinds of tasks as judges who are inferior officers.

required to defer to their factual findings. 204 F.3d at 1133. Here, like the FDIC's Board, the Commission similarly need not defer to the ALJ's factual findings but reviews them *de novo.*

SEC ALJs also differ from special trial judges of the Tax Court in other significant respects. The Supreme Court observed in *Freytag* that special trial judges exercise "a portion of the judicial power of the United States" pursuant to statute. 501 U.S. at 891. SEC ALJs, of course, exercise no such power. Moreover, whereas "the legislative history shows that Congress knowingly expanded the authority of special trial judges and appreciated the significance of that action," *Samuels, Kramer*, 930 F.2d at 982, as discussed below, the ALJ regime has been firmly established for decades with little change to the salient features that indicate Congress's intent to treat ALJs as employees.

B. The History of the ALJ System, the ALJs' Appointments, and the Placement of ALJs Within the Competitive Service System Confirm that Congress Intended ALJs to be Employees

To the extent that there is any doubt that ALJs are employees rather than officers, the Commission should defer to Congress's long-standing judgment—as reflected in Congress's specified method of appointing ALJs as well as its placement of ALJs within the competitive service system—that ALJs are employees. *See Weiss v. United States*, 510 U.S. 163, 194 (1994) (Souter, J., concurring) ("in the presence of doubt" whether military judges are principal or inferior officers, and given that the method Congress chose for selecting them shows that neither Congress nor the President thought military judges were principal officers, "deference to the political branches' judgment is appropriate"). The Constitution assigns to Congress the authority to determine, in the first instance, whether a position it creates is that of an officer or of an employee, *see* U.S. Const. art. II, § 2, cl. 2, and the Commission, like a court assessing such an issue, should defer to Congress's judgment, *see In re Sealed Case*, 838 F.2d 476, 532 (D.C. Cir.) (Ginsburg, J., dissenting) ("That constitutional assignment to Congress counsels judicial deference."), *rev'd sub nom. Morrison v. Olson*, 487 U.S. 654 (1988).

Under the Appointments Clause, inferior officers must be appointed by "the President alone, by the heads of departments, or by the Judiciary." *Buckley*, 424 U.S. at 132. Congress is presumed to know the requirements of the Clause. *E.g.*, *Cannon v. Univ. of Chicago*, 441 U.S. 677, 697 (1979). In fact, when Congress created the position of the modern ALJ in 1946, the method of appointment generally determined the status—employee or officer—of the position. At that time, the Supreme Court had long characterized an appointment pursuant to the methods prescribed in the Appointments Clause as a "well established definition of what it is that constitutes [an officer of the United States]." *United States v. Mouat*, 124 U.S. 303, 307 (1888); *see also United States v. Smith*, 124 U.S. 525, 531-32 (1888); *Germaine,* 99 U.S. at 511; *Wise v. Withers*, 7 U.S. 331, 336 (1806). Yet Congress specified in § 11 of the APA that it is the "agency"—not the President, the Department head, or the judiciary—that appoints ALJs. Pub. L. No. 79-404, 60 Stat. 237, 244 (1946) ("There shall be appointed by and for each agency as many qualified and competent examiners as may be necessary . . . ."); *see* 5 U.S.C. § 3105. In the seven decades since Congress's creation of the ALJ position, Congress has not seen fit to change the method of appointment of ALJs. And Congress clearly knows how to properly appoint officers because Title 5 of the U.S. Code, which governs government organization and employees, defines an "officer" to mean "a justice or judge of the United States and an individual who is required by law to be appointed in the civil service by" the President, a Court of the United States, "*the head* of an Executive agency," or the Secretary of a military department. *Id.* § 2104 (emphasis added). In contrast, an "employee" other than an officer may be "appointed in the civil service by . . . an individual who is an employee under this section." *Id.* § 2105. If there is any doubt whether the ALJs are inferior officers, the way in which Congress provided for their appointment confirms that they are not.

Given the long-standing judgment by Congress that ALJs are not inferior officers, the method specified by Congress for ALJs' appointments can hardly be viewed as a historical accident needing rectification. This is particularly true given that since the creation of the position, ALJs—along with tens of thousands of other federal employees—have been placed in

the competitive service, which is the most basic category within the civil service system. *See Myers*, 272 U.S. at 173; 5 U.S.C. § 2102. The Supreme Court's examination of the Civil Service Commission's regulations of hearing examiners—the precursor of ALJs—was also consistent with the view that ALJs bear no indicia of constitutional officers. *See Ramspeck v. Fed. Trial Exam'rs Conference*, 345 U.S. 128, 130 (1953).

Hearing examiners, like other government employees of that time period, were originally subject to the Classification Act of 1923 and depended on their agency's ratings for compensation and promotion. *Id.* In 1946, due to complaints about hearing examiners' perceived partiality when conducting administrative hearings, Congress enacted the APA to "curtail and change the practice of embodying in one person or agency the duties of prosecutor and judge," while also introducing greater uniformity of procedure and standardization of administrative practice among the diverse agencies. *See Wong Yang Sung v. McGrath*, 339 U.S. 33, 41 (1950). To "separat[e] adjudicatory functions and personnel from investigative and prosecution personnel in the agencies," Congress placed hearing examiners under the jurisdiction of the Civil Service Commission in a merit-based civil service system for federal employees, and vested the Civil Service Commission with control of the ALJs' compensation, promotion, and tenure. *See Ramspeck*, 345 U.S. at 131. Section 11 of the APA specified, for example, that hearing examiners were removable by the employing agency only for "good cause" established and determined by the Civil Service Commission. 60 Stat. at 244.

In enacting these measures to enhance adjudicators' independence in the agencies' administrative process, Congress gave no indication that it meant to elevate the status of hearing examiners above that of the investigative and prosecution personnel of the agency. To the contrary, Congress explicitly "retained the examiners as classified Civil Service employees." *Ramspeck*, 345 U.S. at 133. Thus, on the question of whether hearing examiners' tenure protection precluded an agency from removing them due to a reduction in force, the Supreme Court said that "Congress intended to provide tenure for the examiners *in the tradition of the Civil Service Commission*," namely that "[t]hey were not to be paid, promoted, or discharged at

the whim or caprice of the agency or for political reasons." *Id.* at 142 (emphasis added). This meant that hearing examiners could be subject to the agency's reduction in force, like other employees. *Id.* at 140-41. Similarly, the Court also found that the Civil Service Commission could set various salary grades to reflect the competence and experience of the hearing examiners in each grade—again, like others in the civil service. *Id.* at 136.

Today, OPM, one of the agencies that assumed some of the functions of the Civil Service Commission, is responsible for promulgating rules relating to ALJs and for administering and overseeing the competitive process by which ALJs are screened for positions across federal agencies. An agency may appoint an individual to an ALJ position only with prior approval of OPM, except when it makes its selection from the list of eligible ALJs provided by OPM. 5 C.F.R. § 930.204. The MSPB, another agency that assumed some of the functions of the Civil Service Commission, has jurisdiction over major personnel actions against ALJs. *See* 5 U.S.C. § 7521; 5 C.F.R. §§ 1201.137 *et seq*. Specifically, an ALJ's removal, suspension, reduction in grade or pay, and furlough of certain length must be based on "good cause" established and determined by the MSPB, 5 U.S.C. § 7521; *see also id.* § 1305, whereas for other federal employees, those adverse personnel actions may be taken by their agencies in the first instance with the right to appeal to the MSPB, *id.* §§ 7512, 7701.

Notably, although agencies must proceed through the MSPB in order to take these adverse personnel actions against ALJs, this process is part and parcel of the CSRA's comprehensive remedial scheme for all major personnel actions against federal employees. *Gray v. Office of Pers. Mgmt.*, 771 F.2d 1504, 1510 (D.C. Cir. 1985) (refusing "to confer special status on ALJs beyond that expressly provided by Congress"). Congress enacted the Civil Service Reform Act to overhaul the civil service system and create an "elaborate new framework for evaluating adverse personnel actions against federal employees." *United States v. Fausto*, 484 U.S. 439, 443 (1988) (quotation and alteration omitted). In creating that comprehensive scheme, Congress provided no special remedial routes for ALJs to challenge personnel disputes, except when the challenge involved removal, suspension, reduction in grade or pay, and furlough of

certain length. This is true even when the ALJ alleges that the employing agency's action has affected his or her decisional independence. *See, e.g.*, *Mahoney*, 721 F.3d at 636-37; *Brennan v. HHS*, 787 F.2d 1559, 1562-63 (Fed. Cir. 1986).

Also telling is the fact that ALJs are "subordinate to [the employing agency] in matters of policy and interpretation of law." *Nash*, 869 F.2d at 680; *see Ho v. Donovan*, 569 F.3d 677, 682 (7th Cir. 2009) (fact that different ALJs applied agency regulation differently does not mean that the agency has changed course because "[n]one of the ALJs is authorized to set or change agency policy"). This is consistent with the concept that "civil servants are not thought to be the President's policymakers." *In re Sealed Case,* 838 F.2d at 497. In contrast with ALJs, who are competitive service employees hired from a civil service examination, those employees who occupy confidential, policy-determining or policy-making positions in the "excepted service" cannot appeal adverse personnel actions to the MSPB and may be removed without cause. 5 U.S.C. § 7511(b)(2).[4]

In sum, contrary to Respondents' argument that SEC ALJs are constitutional officers exercising significant authority pursuant to the laws of the United States, SEC ALJs are like other federal employees. Their selection is governed by OPM, the same federal agency that governs all federal employment matters; their employment is governed by the CSRA, the framework for evaluating adverse personnel actions against federal employees; and they go to the same adjudicative body for employment disputes, the MSPB, as other federal employees. In all these ways, ALJs are like other federal employees, and at a minimum, Congress views them as standing in a different constitutional footing than inferior officers, who "determine[] the policy and enforce[] the laws of the United States." *Free Enterprise*, 561 U.S. at 484; *see id.* at 506-07 (noting that "[s]enior or policymaking positions in government may be excepted from the

[4] *See Stanley v. U.S. Dep't of Justice*, 423 F.3d 1271, 1274 (Fed. Cir. 2005) (MSPB has no jurisdiction to hear claims by U.S. Trustees who were removed before the expiration of their terms, because the position of U.S. Trustee was classified as confidential and policy-making and because "inferior officers may be removed before the end of their [] term"); *see also* 5 U.S.C. § 2302(a)(2)(B)(i) ("covered position" for purposes of appeal of personnel actions does not include those "excepted from the competitive service because of its confidential, policy-determining, policy-making, or policy-advocating character").

competitive service to ensure Presidential control," and emphasizing that "nothing in [the Court's] opinion, therefore, should be read to cast doubt on the use of what is colloquially known as the civil service system within independent agencies").

II. Even If SEC ALJs Are Inferior Officers, There Is No Separation-of-Powers Violation

Ultimately, the Commission need not decide whether SEC ALJs are inferior officers or employees, because even if they are inferior officers, the removal provisions applicable to them do not implicate separation-of-powers concerns. The Supreme Court has repeatedly held that the Constitution permits Congress to place reasonable restrictions on the removal of inferior officers without unduly infringing upon the President's exercise of the Executive power. *See, e.g.*, *Myers*, 272 U.S. at 161; *United States v. Perkins*, 116 U.S. 483, 485 (1886). Congress may provide that inferior officers may be removed only for cause without implicating separation-of-powers concerns.

Respondents nonetheless argue (Br. at 38-39) that the removal framework applicable to SEC ALJs deprives the President of adequate control of the executive power. In Respondents' view, SEC ALJs are sheltered by too many levels of tenure protection to enable the President to "take Care that the Laws be faithfully executed." U.S. Const. art. II, § 3. This argument springs from—and misunderstands—*Free Enterprise*, which addresses the constitutionality of sheltering an entire independent sub-agency with "expansive powers to govern an entire industry"—the Public Company Accounting Oversight Board—under two layers of tenure protection. 561 U.S. at 485, 504-08. But that decision does not, given the "size and variety of the Federal Government," announce a blanket rule establishing that a removal framework is per se unconstitutional if more than one layer of tenure protection separates the President from an inferior officer. *Id.* at 506. Indeed, the Court explicitly declined to "address that subset of independent agency employees who serve as administrative law judges." *Id.* at 507 n.10.

Rather, the question posed to the Commission, which is the question posed in any case concerning the removal power, is simply whether the President retains adequate control over the

executive power with respect to SEC ALJs (if those ALJs are in fact officers of the United States). *See Morrison*, 487 U.S. at 689-90 (a removal framework is constitutional if it does not "interfere with the President's exercise of the 'executive power' and his constitutionally appointed duty to 'take care that the laws be faithfully executed' under Article II" (quoting U.S. Const. art. II, § 3)). The President retains adequate control here. SEC ALJs possess only adjudicatory authority, unlike the PCAOB, which has vast rulemaking, investigative, and adjudicatory powers; they are empowered by the Commission—*i.e.*, the Executive—whereas the PCAOB was empowered by Congress; they play a part in a process over which the Commission retains ultimate control from start to finish, whereas the PCAOB was in relevant respects outside of the SEC's control; they enjoy weaker tenure protection than the members of the PCAOB did; and a long history and acceptance of ALJs' use—in contrast to the PCAOB, an organization without precedent—establishes a gloss on the Constitution, *see Dames & Moore v. Regan*, 453 U.S. 654, 686 (1981). The removal framework that Respondents challenge does not infringe on the President's executive authority. Respondents' request for the Commission to strike out into uncharted territory and transform the fact-specific holding of *Free Enterprise* into a rigid, one-size-fits-all rule should be rejected.

Precedent regarding executive-branch adjudicators supports the conclusion that the removal framework is constitutional. The Supreme Court has historically been solicitous of tenure protections for executive-branch officials who exercise adjudicatory power. In *Humphrey's Executor v. United States*, 295 U.S. 602, 628-29 (1935), the Court overruled *Myers*, 272 U.S. 52, and held that the President need not have the unfettered ability to dismiss the Commissioners of the Federal Trade Commission in part because they exercised "quasi[-]judicial" authority. Similarly, the Court in *Wiener v. United States* concluded that the Constitution did not give the President unfettered discretion to remove a member of an adjudicatory body (known as the War Claims Commission), notwithstanding that no statute created tenure protection for the members of that body, given their adjudicatory function. 357 U.S. 349, 353-56 (1958). And in *Free Enterprise*, the Supreme Court again signaled that

adjudicators are different when it explained that its decision "does not address that subset of independent agency employees who serve as administrative law judges," as "unlike members of the [PCAOB] . . . [they] perform adjudicative rather than enforcement or policymaking functions." 561 U.S. at 507 n.10. SEC ALJs, of course, exercise only adjudicatory authority. 17 C.F.R. § 201.111.

While the Supreme Court concluded in *Free Enterprise* that the removal restrictions applicable to the members of the PCAOB, who exercised some adjudicatory authority, violated the Constitution, 561 U.S. at 495-96, it did so, in part, because the members of the PCAOB operated under two layers of tenure protection: by statute, the PCAOB members could be removed only by the Commission and only for "willful violations of the [Sarbanes-Oxley] Act, Board rules, or the securities laws; willful abuse of authority; or unreasonable failure to enforce compliance," *id.* at 503; and it is understood that the President can remove the Commissioners only for "inefficiency, neglect of duty, or malfeasance in office," *id.* at 487 (quotation omitted). In short, the Court decided that the President lacked constitutionally adequate control over the PCAOB. But a review of *Free Enterprise* demonstrates why the opposite conclusion regarding the President's control of SEC ALJs is warranted here.

A. The President Lacked Sufficient Control of the PCAOB

The PCAOB of *Free Enterprise* was powerful, largely independent from the SEC, shielded by an "unusually high standard" of tenure protection, relatively new, and empowered by Congress rather than by the Commission. 561 U.S. at 503-08. Consider first the Board's power. The PCAOB is "the regulator of first resort and the primary law enforcement authority for a vital sector of our economy." *Id.* at 508. It has "expansive powers to govern an entire industry." *Id.* at 485. "[T]he Board may regulate every detail of an accounting firm's practice, including hiring and professional development, promotion, supervision of audit work, the acceptance of new business and the continuation of old, internal inspection procedures, professional ethics rules, and 'such other requirements as the Board may prescribe.'" *Id.* (quoting 15 U.S.C. § 7213(a)(2)(B)). To accomplish these ends, the "Board promulgates auditing and ethics

standards, performs routine inspections of all accounting firms, demands documents and testimony, and initiates formal investigations and disciplinary proceedings." *Id.*

Not only does the PCAOB have expansive powers, but in important respects, it stands outside of the SEC's control. First, the Board is a multi-member body, so the SEC could not supervise individual members without regulating the entire Board (and in potentially drastic ways). *Id.* at 504 ("The Commission cannot wield a free hand to supervise individual members if it must destroy the Board in order to fix it."). Second, the "Board is empowered to take significant enforcement actions, and does so largely independently of the Commission." *Id.* "The Board thus has significant independence in determining its priorities and intervening in the affairs of regulated firms (and the lives of their associated persons) without Commission preapproval or direction." *Id.* at 505.

Coupled to this power and independence was an extraordinary level of tenure protection. According to the Court, the Board operated under two levels of tenure protection that "present[ed] an even more serious threat to executive control than an 'ordinary' dual for-cause standard." *Id.* at 502.

In addition, the Board was relatively new; it had been in existence for less than a decade when *Free Enterprise* was decided in 2010. *Id.* at 484. Neither the parties to the case nor the United States, which intervened in the matter, were able to identify any historical analog for the PCAOB, *i.e.*, an "independent agency . . . appointed by and removable only for cause by another independent agency." *Id.* at 505-06. Thus, there was no history involving the Board that would provide a "gloss" on the Constitution and, therefore, affect the review of its constitutionality. *Dames & Moore*, 453 U.S. at 686 (explaining that "a systematic, unbroken, executive practice, long pursued . . . may be treated as a gloss on Executive Power vested in the President" (quotation omitted)).

Finally, the Supreme Court in *Free Enterprise* emphasized that the "Sarbanes-Oxley Act," whereby Congress created the PCAOB, "is highly unusual" in that it also "*commit[s] substantial executive authority* to officers protected by two layers of for-cause removal." 561

U.S. at 505 (emphasis added). Not only did Congress establish the Board, but Congress also empowered it. And crucially, "the [Sarbanes-Oxley] Act nowhere gives the Commission executive power to start, stop, or alter individual Board investigations." *Id.* at 504.

Taken together, this mix of factors—power, independence from the SEC, tenure protection, history, and the fact that Congress endowed the PCAOB with executive powers over which the Commission lacked control—led the Court to conclude that Congress had deprived the President of adequate control over executive authority. *Id.* at 508. But SEC ALJs differ from members of the PCAOB with regard to each of the factors described above. Thus, their removal framework does not impermissibly encroach on the President's executive authority.

B. The President Exercises Adequate Control Over SEC ALJs

First, while Congress created the position of ALJ and made ALJs available for agencies' use, it is not *Congress* that has delineated the scope of SEC ALJs' duties. Rather, it is the *Commission* that has elected, in the exercise of its discretion, to hire ALJs, to empower them to carry out certain (limited) functions, and to determine in each case whether to use ALJs to preside over the initial stages of an administrative proceeding. 17 C.F.R. §§ 201.101 *et seq*. The separation-of-powers principles embodied in the Constitution prohibit Congress from encroaching on the executive authority. That Congress has permitted agencies to use—or not to use—ALJs as the *agencies* see fit does not effect an abrogation of executive authority. *See, e.g.*, *Morrison*, 487 U.S. at 689-90 ("The analysis contained in our removal cases is designed not to define rigid categories of those officials who may or may not be removed at will by the President, but to ensure that Congress does not interfere with the President's exercise of the executive power . . . ." (footnote omitted)). Furthermore, just as the Commission has empowered its ALJs, the Commission—without need of any action by Congress—could disempower them. No statute prevents the Commission from deciding as a general matter not to use ALJs, or, with regard to a specific enforcement action, deciding "in its discretion" to assign a person other than an ALJ to serve as a hearing officer for an administrative proceeding, 17 C.F.R. § 201.101(5), or

to bring an action in federal district court instead of in an administrative proceeding, *id.* § 202.5(b); *see also, e.g.*, 15 U.S.C. §§ 80b-3, 80b-9.

Second, the functions that the Commission has assigned to its ALJs are limited in scope and do not rise to the level of the exercise of core executive authority. ALJs do not draft regulations. 17 C.F.R. § 201.111 (setting out the powers of a hearing officer). They do not initiate investigations. *Id.* They are not a separate agency regulating an entire sphere of the economy. Rather, they adjudicate cases. *Id.* The adjudication of cases does not involve the kind of far-reaching policy decisions inherent in the PCAOB's rulemaking and enforcement functions. *See Morrison*, 487 U.S. at 691 (functions served by officers relevant to determining whether the President has sufficient control). As then-professor Elena Kagan pointed out, the difference between rulemaking and adjudicating is the "distinction between relatively open-ended policymaking potentially affecting and involving trade-offs among broad social groups and relatively circumscribed resolution of discrete claims involving identifiable firms or individuals." Kagan, *Presidential Administration*, 114 Harv. L. Rev. 2245, 2363 (2001). And decisions about enforcement often "involve[] a complicated balancing of a number of [policy] factors": An "agency must not only assess whether a violation has occurred, but whether agency resources are best spent on this violation or another, whether the agency is likely to succeed if it acts, whether the particular enforcement action requested best fits the agency's overall policies" and "whether the agency has enough resources to undertake the action at all." *Heckler v. Chaney*, 470 U.S. 821, 831 (1985). Adjudications by SEC ALJs, on the other hand, do not involve the same kind of important policy choices; they involve the application of the law to a discrete set of facts in individual cases. *See generally* Neomi Rao, *Removal: Necessary and Sufficient for Presidential Control*, 65 Ala. L. Rev. 1205, 1248 (2014) ("Executive branch adjudicators are not generally thought to have discretion in th[e] sense [of one engaged in rulemaking or enforcement actions], but rather like other judges to be applying the law to particular facts.").[5]

[5] These responsibilities comport with the principle that ALJs must follow the agency's lead with respect to matters of policy. *E.g.*, *Ho*, 569 F.3d at 682 ("None of the ALJs is authorized to set or change agency policy; only the

Third, because the Commission retains ultimate authority over administrative proceedings, the Commission exercises sufficient control over SEC ALJs regardless of the limitations placed upon their removal. SEC ALJs do not choose the cases that they adjudicate; the Commission---over which the President exercises constitutionally adequate control, *see Humphrey's Executor*, 295 U.S. 602—decides whether a matter will be heard in an administrative proceeding, or whether it will be brought in federal district court, 17 C.F.R. § 202.5(b). And, as already discussed, the SEC has plenary authority over its ALJs. Among other things, ALJs issue "initial decision[s]," which the Commission reviews under a *de novo* standard. *Id.* §§ 201.360, 201.410, 201.411, 201.452. The SEC did not have similar control over the PCAOB's activities: Certain activities of the PCAOB were for all practical purposes outside of the SEC's control. *Free Enterprise*, 561 U.S. at 504-05.[6]

Fourth, not only do SEC ALJs have less power and independence than the PCAOB, but they also enjoy less robust tenure protection than the members of the PCAOB did. SEC ALJs may be removed for "good cause." 5 U.S.C. § 7521. A member of the PCAOB, by contrast, could be removed only "for willful violations of the [Sarbanes-Oxley] Act, [PCAOB] rules, or the securities laws; willful abuse of authority; or unreasonable failure to enforce compliance." *Free Enterprise*, 561 U.S. at 503. The Supreme Court recognized that the PCAOB's removal standard was higher, and thus more threatening to the President's authority, than the ordinary good-cause standard (like the one applicable to SEC ALJs). *Id.* at 503. Because SEC ALJs have weaker tenure protection than the PCAOB, the President has more control over the ALJs' exercise of executive authority.

Secretary can do that."); *Nash*, 869 F.2d at 680 ("An ALJ is a creature of statute and, as such, is subordinate to the Secretary in matters of policy and interpretation of law.").

[6] While the Supreme Court held in *Free Enterprise* that the SEC's generalized control over the PCAOB's functions was not constitutionally sufficient because it did not provide the SEC with a means of supervising individual Board members, 561 U.S. at 504, no similar concern applies here. The SEC's supervisory authority is not so imprecise with respect to ALJs. It can overturn an individual ALJ's decision in a particular case; it need not—to draw an analogy to *Free Enterprise*—overrule all initial decisions by all ALJs that have not yet been finalized.

Fifth, the Executive Branch's use of tenure-protected ALJs for nearly seventy years establishes a gloss on the Constitution that supports the current removal framework. ALJs have enjoyed tenure protection since the enactment of the APA in 1946. 60 Stat. at 244. Moreover, the SEC Commissioners have long been understood to be subject to removal only for cause. *E.g.*, *MFS Securities Corp. v. SEC*, 380 F.3d 611, 619-20 (2d Cir. 2004). Thus, unlike the PCAOB, which was only several years old when first challenged, SEC ALJs have operated under a removal framework similar to that which currently applies for almost 70 years. In that time, there has been no indication that the President's ability to faithfully execute the law has been hampered by the ALJs' removal framework.

While it is true that "the separation of powers does not depend on the views of individual Presidents," *Free Enterprise*, 561 U.S. at 497, it is also true that "a systematic, unbroken, executive practice, long pursued . . . may be treated as a gloss on Executive Power vested in the President," *Dames & Moore*, 453 U.S. at 686 (quotation omitted). And the fact that eleven Administrations of both parties have used ALJs over nearly many decades without any apparent impairment indicates that the President's constitutional authority has not been hampered. Importantly, this is not a situation where the use of ALJs allows the President to "escape responsibility for his choices by pretending that they are not his own." *Free Enterprise*, 561 U.S. at 497. If nothing else, the Commission's ability to modify or vacate ALJs' functions and decisions ensures that the President is fully accountable for the SEC's actions. *See, e.g.*, 15 U.S.C. § 78d-1; 17 C.F.R. § 201.411.

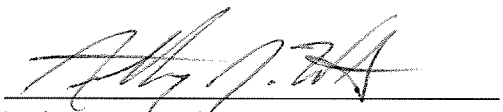
SEC ALJs exercise only the small fraction of executive authority that the Commission has delegated to them (unlike the PCAOB, which exercises broad executive authority that Congress has granted to it); they are subject to greater control by the President and by the Commission than are the members of the PCAOB; and they benefit from nearly seven decades of Executive acceptance. Thus, the President maintains ample control over his executive authority, and SEC ALJs' removal framework does not "deprive the President of adequate control over the [SEC ALJs]." *Free Enterprise*, 561 U.S. at 508.

CONCLUSION

For the foregoing reasons, Respondents' Article II challenge to their administrative proceeding should be rejected.

This 11th day of February.

Respectfully submitted,



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