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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.

RESPONDENTS' SUPPLEMENTAL BRIEF ON THE SEPARATION OF POWERS ISSUE

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I. INTRODUCTION

This case highlights the numerous constitutional infirmities of the Commission's administrative forum and procedure. The Commission's choice of forum not only deprived Respondents of their Constitutional rights to equal protection and ultimately due process, but the underlying proceeding itself is unconstitutional because it violates the Separation of Powers. In *Free Enterprise Fund v. Public Company Accounting Oversight Board,* 561 U.S. 477 (2010), the Supreme Court held that executive officers may not be separated from Presidential supervision and removal by more than one layer of tenure protection. SEC Administrative Law Judges are inferior Executive officers who exercise significant authority in presiding over an administrative trial and, like the members of the board of the PCAOB in *Free Enterprise*, are protected by two layers of tenure protection. As in *Free Enterprise*, this dual for cause tenure protection violates the Separation of Powers. Therefore the underlying SEC administrative proceeding before the SEC's Administrative Law Judges in this matter and the findings made therein are unconstitutional.

The Division of Enforcement's arguments in opposition do not save this constitutionally flawed system. First, the Division understates the authority of SEC ALJs and overstates the finding of the D.C. Circuit in *Landry v. F.D.I.C.*, 204 F.3d 1125 (D.C. Cir. 2000). The *Landry* court did not find that all administrative ALJs are employees and not inferior Executive officers. Rather, the court found that the FDIC's ALJs' authority, which is significantly different from SEC ALJs' authority, did not rise to the same level as Special Trial Judges in *Freytag v. Commission of Internal Revenue*, 501 U.S. 868 (1991) and thus FDIC ALJs are not inferior Executive officers. Supreme Court precedent in *Freytag* and other cases establish that an adjudicator with nearly identical authority as an SEC ALJ is an inferior Executive officer.

Second, the Division argues that even if SEC ALJs are inferior officers the Supreme Court's ruling in *Free Enterprise* is limited to situations involving whole agencies protected by dual for cause tenure protection. The holding in *Free Enterprise*, however, was not so limited. As set forth below, the Supreme Court's rulings in *Freytag* and *Free Enterprise* compel a finding that the underlying proceedings here and the resulting Initial Decision were unconstitutional.

II. BACKGROUND

A. Administrative Law Judges and the Administrative Procedure Act ("APA")

The Administrative Law Judge ("ALJ") position is established by statute, which provides that "[e]ach agency shall appoint as many administrative law judges as are necessary for proceedings required to be conducted in accordance with sections 556 and 557 of this title." 5 U.S.C. § 3105. The APA's procedures, including the use of ALJs as presiding officers, apply "in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing . . ." 5 U.S.C. § 554(a). The APA requires that agency adjudications must be presided over by "(1) the agency, (2) one or more members of the body which comprises the agency; or (3) one or more administrative law judges appointed under Section 3105 of this title." 5 U.S.C. § 556 (b).[1] The APA prohibits an agency employee engaged in investigative or prosecuting functions from participating or advising in the decision issued by an ALJ. 5 U.S.C. § 554 (d). An ALJ's decision becomes a final decision of the agency without further proceedings "unless there is an appeal to, or review on motion of, the agency within the time provided by rule." 5 U.S.C. § 557. Under the APA, ALJs may –

- administer oaths and affirmations;

[1] 5 U.S.C. § 556 (b) also states this subsection does not control over contrary legislation that provides for a different scheme—"This subchapter does not supersede the conduct of specified classes of proceedings, in whole or in part, by or before boards or other employees specifically provided for by or designated under statute." Here, there is no contrary legislation.

- issue subpoenas authorized by law;
- rule on offers of proof and receive relevant evidence;
- take depositions or have depositions taken when the ends of justice would be served;
- regulate the course of the hearing;
- hold conferences for the settlement or simplification of the issues by consent of the parties or by the use of alternative means of dispute resolution as provided in subchapter IV of this chapter;
- inform the parties as to the availability of one or more alternative means of dispute resolution, and encourage use of such methods;
- require the attendance at any conference held pursuant to paragraph (6) of at least one representative of each party who has authority to negotiate concerning resolution of issues in controversy;
- dispose of procedural requests or similar matters;
- make or recommend decisions in accordance with section 557 of this title; and
- take other action authorized by agency rule consistent with this subchapter.

5 U.S.C. §556(c).

B. SEC Administrative Proceedings and the Position of SEC ALJ

SEC regulations establish the "Office of Administrative Law Judges" and provide that SEC ALJs are "to conduct hearings in proceedings instituted by the Commission." 17 C.F.R. § 200.14. The SEC, like other agencies, selects ALJs from a list of eligible candidates provided by the Office of Personnel Management ("OPM") based on the SEC's needs. *See* 5 C.F.R. § 930.204. ALJs receive career appointments and are removable "only for good cause established and determined by the Merit Systems Protection Board on the record after opportunity for hearing before the Board." 5 CFR § 930.204(a); 5 U.S.C. § 7521. Members of the Merit Systems Protection Board are also protected by tenure and, like SEC Commissioners, are removable by

the President "only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. §1202(d); *Free Enterprise*, 561 U.S. at 487.

ALJs' salaries are specified by statute and set forth in Schedule 10 of Executive Order No. 13655. There are eight levels of basic pay for ALJs, the lowest of which may not be less than 65% of the rate of basic pay for level IV of the Executive Schedule, and the highest of which may not be more than the rate of basic pay for level IV of the Executive Schedule. 5 U.S.C. § 5372. The Executive Schedule is a system of salaries given to the highest-ranked appointed positions in the executive branch of the U.S. government. 5 U.S.C. § 5311.

Congress has given the SEC authority to bring enforcement actions both administratively and in federal court. The securities laws, however, provide no guidance as to when an enforcement action should be prosecuted administratively or in federal courts or both. On its website, the SEC states that "[w]hether the Commission decides to bring a case in federal court or within the SEC before an administrative law judge may depend upon various factors. Often, when the misconduct warrants it, the Commission will bring both proceedings."[2] The Commission, however, provides no guidance as to what those factors are. In 2014, the Commission instituted over 600 administrative proceedings, which was approximately 35% more than the number of administrative proceedings brought in 2012. Susan D. Resley, *Dealing with the SEC's Administrative Proceeding Trend*, Law360, Jan. 13, 2015. In the fiscal year ending September 30, 2014, 43% of the Commission's litigated enforcement cases were brought as administrative proceedings. *Id.* Over the past year, the Commission has hired two new administrative law judges and three new lawyers to the administrative law staff, bringing the total number of SEC Administrative Law Judges to 5 and doubling the size of the clerk pool

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2 www.sec.gov/News/Article/Detail/Article/1356125787012.

serving the judges. Sarah N. Lynch, *U.S. SEC Beefs Up Administrative Court to Meet Rising Demand*, Reuters, June 30, 2014.

C. SEC ALJ's Exercise Significant Authority

An SEC ALJ's authority with respect to adjudications is to be as broad as the APA allows. 17 CFR § 201.111 ("No provision of these Rules of Practice shall be construed to limit the powers of the hearing officer provided by the Administrative Procedure Act, 5 U.S.C. § 556, 557."). On its web page, the SEC maintains a separate page for the Office of Administrative Law Judges, which describes that SEC ALJs are –

> independent judicial officers who in most cases conduct hearings and rule on allegations of securities law violations initiated by the Commission's Division of Enforcement. They conduct public hearings . . . in a manner similar to non-jury trials in the federal district courts. Among other actions, they issue subpoenas, conduct prehearing conferences, issue defaults, and rule on motions and the admissibility of evidence. At the conclusion of the public hearing, the parties submit proposed findings of fact and conclusions of law.

See www.sec.gov/alj.

Under the SEC Rules of Practice and other SEC regulations, an SEC ALJ is empowered, within his or her discretion, to perform functions that otherwise would be performed by the Commission or its members. This authority to conduct hearings amounts to control of the underlying record of the proceedings by an SEC ALJ, who has the authority to—

- Regulate "the course of a proceeding and the conduct of the parties and their counsel" (Rules of Practice 111(d));
- Receive "relevant evidence" and rule upon "the admission of evidence and offers of proof" (*Id.* 111(c));
- Order production of evidence (*Id.* 230(a)(2), 232); Issue subpoenas (*Id.* 232); and Regulate the SEC's use of investigatory subpoenas after the institution of proceedings (*Id.* 230(g));

- Rule on applications to quash or modify subpoenas (*Id.* 232(e));
- Order depositions, and act as the "deposition officer" (*Id.* 233, 234);
- Modify the Rules of Practice with regard to the SEC's document production obligations (*Id.* 230(a)(1));
- Require the SEC to produce documents it has withheld (*Id.* 230(c));
- Grant or deny the parties' proposed corrections to hearing transcript. (*Id.* 302(c));
- Allow the use of prior sworn statements for any reason, and limit or expand the parties' intended use of the same (*Id.* 235(a), (a)(5));
- Issue protective orders governing confidentiality of documents (*Id.* 322);
- Take "official notice" of facts not appearing in the record (*Id.* 323); and
- Regulate the scope of cross-examination (*Id.* 326).

SEC ALJs also control the scope of the issues presented in the administrative proceeding because they, among other things:

- Rule on requests and motions, including pre-trial motions for summary disposition. (See, e.g., *Id.* 250(b));
- Reject filings that do not comply with the SEC's Rules of Practice (*Id.* 180(b));
- Can dismiss the case, decide a particular matter against a party, or prohibit introduction of evidence when a person fails to make a required filing or cure a deficient filing. (*Id.* 180(c));
- Direct that answers to OIPs need not specifically admit or deny, or claim insufficient information to respond to, each allegation in the OIP. (*Id.* 220(c));
- Require the SEC to file a more definite statement of specified matters of fact or law to be considered or determined. (*Id.* 220(d));
- Grant or deny leave to amend an answer (*Id.* 220(e));
- Grant or deny leave to move for summary disposition (*Id.* 250(a)).
- Dismiss for failure to meet deadlines (*Id.* 155(a)); and

- Reopen any hearing prior to the filing of a decision (*Id.* 111(j)).

Ultimately, SEC ALJs issue an Initial Decision "that includes factual findings, legal conclusions, and, where appropriate, orders relief." *See* www.sec.gov/alj. The Commission states that-

> An Administrative Law Judge may order sanctions that include suspending or revoking the registrations of registered securities, as well as the registrations of brokers, dealers, investment companies, investment advisers, municipal securities dealers, municipal advisors, transfer agents, and nationally recognized statistical rating organizations. In addition, Commission Administrative Law Judges can order disgorgement of ill-gotten gains, civil penalties, censures, and cease-and-desist orders against these entities, as well as individuals, and can suspend or bar persons from association with these entities or from participating in an offering of a penny stock.

Id. The SEC publishes the ALJ's Initial Decision in the *SEC Docket*, *see* Rule of Practice 360(c), and on the SEC's website under ALJ Initial Decisions.

A respondent can seek Commission review of the Initial Decision, but Commission review is not mandatory. Rule of Practice 411. The Commission has discretion to grant a review if

> a reasonable showing that: (i) a prejudicial error was committed in the conduct of the proceeding; or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; or (B) a conclusion of law that is erroneous; or (C) an exercise of discretion or decision of law or policy that is important and that the Commission should review."

Id. If a respondent does not file a petition for review and if the Commission does not on its own initiative review the decision, "the Commission will issue an order that the [initial] decision [of the SEC ALJ] has become final." Rules of Practice 360(d)(2). Upon issuance of the order that the SEC ALJ's initial decision has become final, referred to as an "order of finality," *see* Rules of Practice 360(d)(2), "the action of [the] administrative law judge ... shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 18 U.S.C. § 78d-1(c). Even when

reviewing an ALJs' Initial Decision, the Commission gives the ALJ's credibility determinations "significant deference" and ultimately courts have also given deference to an ALJ's credibility determinations.

D. The Authority Exercised By the SEC ALJs in The Underlying Proceeding

The Commission instituted this action on September 24, 2013, and ordered that Chief Judge Brenda P. Murray preside at the hearing. *See* SEC Adm. Proceedings Rulings No. 915 (Sept. 26, 2013). Chief Judge Murray granted Respondents leave to file a motion for summary disposition and set a schedule for briefing on the motion as well as a trial schedule. *See* SEC Adm. Proceedings Rulings Release No. 969 (Oct. 18, 2013); SEC Adm. Proceedings Rulings No. 138 (Nov. 14, 2013). Respondents also filed a motion to compel the production of *Brady* material and the Division filed a motion for a protective order seeking the return of documents the Division claimed to be privileged, which the Respondents argued contained *Brady* material. Chief Judge Murray ruled on both those motions, finding for the Division that the documents did not contain *Brady* material. SEC Adm. Proceedings Rulings No. 1069 (Nov. 25, 2013). Chief Judge Murray also denied Respondents' motion for summary disposition. SEC Adm. Proceedings Rulings No. 1101 (Nov. 14, 2013).

On December 16, 2013, Chief Judge Murray designated ALJ Cameron Elliot to preside over this matter. ALJ Elliot set a schedule for the hearing, including a schedule for the issuance of expert reports and motions in limine. ALJ Elliot ruled on requests for the issuance of subpoenas and motions to quash subpoenas, including denying in part Respondents' subpoena request for documents. SEC Adm. Proceedings Rulings No. 1173 (Jan. 15, 2014). ALJ Elliot presided over the hearing, which took place over the course of eight non-consecutive days. ALJ Elliot ruled on the admissibility of evidence and the scope of witness testimony and issues presented at trial. After the conclusion of the hearing, both parties submitted post-hearing briefs

reviewed by ALJ Elliot. Ultimately, in a 73 page Initial Decision issued on August 20, 2014, ALJ Elliot ruled that Timbervest violated Sections 206(1) and (2) of the Investment Advisers Act and that the individual Respondents acted with scienter in aiding and abetting and causing those violations. ALJ Elliot also ruled on Respondents' statute of limitations defense, finding that the statute of limitations applied to the Division's request for associational bars and registration revocation. Additionally, ALJ Elliot ordered Respondents to cease and desist from committing or causing violations of 206 (1) and (2) and ordered disgorgement of approximately $1.9 million plus additional prejudgment interest. The SEC published the Initial Decision in Volume 109, Number 12 of SEC Docket, and also published the decision on the Office of Administrative Law Judge webpage on the SEC's website.[3] Based on ALJ Elliot's ruling, on August 21, 2014, the Atlanta Business Chronicle published an article titled "SEC: Judge Rules Timbervest Principals Committed Fraud."

III. ARGUMENT

A. SEC ALJs, Including the SEC's ALJs That Presided Over The Hearing, Are Inferior Officers

By reason of their position, the significant authority granted to them, and the authority SEC ALJs in fact exercise, SEC ALJs, including the ALJs that presided over this matter, are inferior officers. In *Freytag v. C.I.R.*, 501 U.S. 868 (1991), the Supreme Court held that a Special Trial Judge ("STJ") appointed by the Chief Judge of the Tax Court was an "inferior Officer." *Freytag*, 501 U.S. at 881-82. The petitioners in *Freytag* challenged the ruling of the STJ arguing that an STJ was an "Officer" of the United States and the assignment of their case to an STJ violated the Appointments Clause of the Constitution. *Id.* at 877. In determining whether an STJ was an inferior officer, the Supreme Court stated that "'[A]ny appointee exercising significant

[3] *See* www.sec.gov/about/docket/2014/sec-docket-109-12.xml and www.sec.gov/alj/aljdec/aljdecarchive/aljdecarc2014.shtml

authority pursuant to the laws of the United States is an 'Officer of the United States,' . . . ." *Id.* at 881 (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976)). The Commissioner for the IRS argued that STJs were not inferior officers, but employees because the STJ lacked authority to enter a final decision in the matter before it. *Id.* at 881. The Supreme Court found that the Commissioner's argument "ignores the significance of the duties and discretion that special trial judges possess." *Id.* Further, the Court stated that "[t]he 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." *Id.* (citing *Burnap v. United States*, 252 U.S. 512, 516-517 (1920); *United States v. Germaine*, 99 U.S. 508, 511-512 (1979)). The Court found that

> 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 a 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.

Id.

The position of SEC ALJ and the authority exercised by SEC ALJs is nearly identical to the STJs in *Freytag*. Specifically, Congress, by law, established the position of ALJ in the APA and their duties, salary, and means of appointment for that office are specified by statute. *See* 5 U.S.C. § 556, 557, 3105, 5311; 15 U.S.C. § 78d-1. Like STJs, ALJs, among other things take testimony, conduct trials, rule on the admissibility of evidence, issue subpoenas, and make substantive rulings and findings. *See infra*, p.3, 5-7. The ALJs that presided over this proceeding exercised their significant authority by regulating the course of the proceeding, issuing scheduling orders, ruling on a motion for summary disposition, ruling on *Brady* issues and the admissibility of evidence, issuing subpoenas and ruling on motions to quash subpoenas, allowing

the Division to present evidence and allegations beyond those alleged in the OIP, and ultimately issuing an Initial Decision that made findings of fact, including finding that Respondents acted with scienter and violated the antifraud provisions of the Investment Advisers Act. The Initial Decision also imposed relief that included disgorgement of approximately $1.9 million and issued a cease and desist order.

The ALJ's Initial Decision was then published on *SEC Docket* and on the SEC ALJs' webpage.[4] Once published, negative effects flow. Reputational harm ensues that has reverberating effects, including the loss of clients, jobs and livelihood—all before the Commission even reviews the Initial Decision. No other SEC staff person has the authority to publicly make allegations that an individual or entity have violated the law until the Commission authorizes them to do so. Thus, based on their positions and the authority granted to them by Congress and the SEC, SEC ALJs, including the SEC ALJs who presided over this case, exercise significant authority that make them inferior officers.

B. The Division's Arguments That its ALJs and the ALJs in This Matter Are Not Inferior Officers Are Flawed

1. It is Irrelevant that Congress Did Not Explicitly Require the SEC to Use ALJs

The Division first claims that SEC ALJs are "lesser functionaries subordinate to officers of the United States" and this is supposedly evidenced by the fact that Congress has not mandated that the SEC use ALJs at all. The Division, however, ignores the Administrative Procedure Act. In prosecuting this case administratively, and others like it, the SEC is bound by

[4] Not only was the Initial Decision published, but several days after the Initial Decision was published, the Atlanta Business Chronicle published an article titled "SEC: Judge Rules Timbervest Principals Committed Fraud." The article states that "Administrative Law Judge Cameron Elliot found Atlanta-based Timbervest LLC and its four principals committed fraud and ordered them to disgorge almost $2 million in unlawful profits, the Securities and Exchange Commission reported Thursday."

the APA and the APA requires that the Commission itself, one or more members of the Commission, or one or more administrative law judges appointed under Section 3105 of the APA preside over the hearing. 5 U.S.C. § 556. Although the Commission itself or its members could have presided over the trial in this matter, it did not and Congress has mandated that in such a circumstance an ALJ preside. Furthermore, although Congress did not explicitly require that the Commission use its ALJs, given the number of administrative cases (over 600 last year), it is disingenuous to suggest that Congress had anything else in mind other than that an ALJ would in fact preside over the majority, if not all, administrative adjudications. As mentioned above, the SEC has nearly doubled its staff of ALJs over the last several years.[5]

The Division also ignores that in *Freytag* the Chief Judge of the Tax Court was also not required to use STJs. *Freytag*, 501 U.S. at 871 (citing 26 U.S.C. § 7443A(a)); 26 U.S.C. § 7443A(a) ("The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.") Accordingly, the fact that Congress did not explicitly require the SEC to use ALJs is simply not relevant. What is relevant is that Congress created the position of ALJ and requires all administrative agencies to use them if the agency itself or a member of the agency does not preside over the matter.[6]

2. Whether Or Not The ALJ's Initial Decision is A Final Decision is Not Determinative of Whether an SEC ALJ is an Inferior Officer

The Division next argues that SEC ALJs prepare "preliminary," and not final, decisions of the SEC and that this makes SEC ALJs lesser functionaries and not inferior officers. In

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[5] The Director of Enforcement recently stated that "we are using administrative proceedings more . . ." Remarks to the American Bar Association's Business Law Section Fall Meeting, Andrew Ceresney, Director, SEC Division of Enforcement, Nov. 21, 2014.

[6] As mentioned above, the APA allows for a different scheme if it is set forth by statute, but that is not the case here.

making this argument the Division relies on the D.C. Circuit's opinion in *Landry v. F.D.I.C.*, 204 F.3d 1125 (D.C. Cir. 2000). The Division's arguments are flawed for several reasons.

First, it is factually incorrect that an SEC ALJ only issues "preliminary" decisions. SEC ALJs regulate the course of the proceedings and control the record for review by the Commission, if the Commission chooses to grant a review. SEC ALJs rule on the scope of the issues presented at trial, on the admissibility of evidence, and on the issuance of the subpoenas—thereby deciding who will testify and what documents and other information is available to be submitted as evidence. Undoubtedly, an SEC ALJ is instrumental in creating the record of the underlying proceeding because it is the ALJ who decides what is in the record. In instances where the Commission grants review of an Initial Decision, the scope of that review is based on the record before the ALJ. Specifically, SEC Rules of Practice 411(a) sets forth the following—

> *Scope of Review.* The Commission may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record.

Moreover, it is the ALJ, not the Commission or any of its members, who actually preside over the testimony of witnesses, including the Respondents' testimony here. Therefore, even in a *de novo* review, the Commission never gets to view the witnesses and assess their credibility under cross-examination. The Commission in fact "give[s] 'considerable weight and deference' to the trier of fact's credibility determinations and reject them only where there is substantial evidence for doing so." *In the Matter of the City of Miami, Florida*, 79 S.E.C. Docket 2580, n4 (2003) (quoting *Jay Houston Meadows*, 52 S.E.C. 778, 784 (1996), *aff'd*, 119 F. 3d 1219 (5th Cir. 1997)). Even if the Commission itself were to find against a credibility determination made by an ALJ, "a reviewing court generally gives substantial deference to the factual findings of an

ALJ, this deference is even greater when credibility determinations are involved." *Gimbel v. Commodity Futures Trading Commission*, 871 F.2d 196, 199 (7th Cir. 1989). An ALJ's status and role goes well beyond a "preliminary role" in a proceeding because the ALJ's finding on credibility carry through not only before the Commission, if the Commission chooses to review the Initial Decision, but to judicial review by a Court of Appeals.

Additionally, the Commission is not obligated to review all Initial Decisions. *See* Rules of Practice 411. In deciding whether to grant "[d]iscretionary review," the Commission considers whether the petition for review makes a reasonable showing that:

> (i) a prejudicial error was committed in the conduct of the proceeding; or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; or (B) a conclusion of law that is erroneous; or (C) an exercise of discretion or decision of law or policy that is important and that the Commission should review.

Rules of Practice 411(b). This is consistent with the APA, which provides that an initial decision "becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule." 5 U.S.C.§ 557(b). If a party does not file a timely petition for review or the Commission does not order review on its own initiative, "the Commission will issue an order that the decision has become final as to that party." Rule of Practice 360(d)(2). Thus, when the Commission does not grant an appeal or a petition review is not filed timely, the Initial Decision of the ALJ becomes the Final Decision. In a majority of SEC administrative enforcement proceedings, the SEC ALJ's initial decision is the final word. For example, in 2014 there were 186 Initial Decisions issued by SEC ALJs and in

174 of them (approximately 94%), the Initial Decision became final through a Finality Order without a *de novo* review by the Commission.[7]

Second, the Division's reliance on *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C.Cir. 2000), is misplaced. In a 2-1 decision on the issue of whether FDIC ALJs were inferior officers, the *Landry* majority found that they were not because their authority was not similar to the STJ's authority in *Freytag*. The majority opinion in *Landry* relied heavily on the fact that FDIC ALJs "can never render the decision of the FDIC" and noted that, unlike an FDIC ALJ, "the Tax Court was required to defer to the STJ's factual and credibility findings unless they were clearly erroneous . . . whereas here the FDIC makes its own factual findings." *Id.* at 1133. The FDIC's ALJs' authority, however, is significantly different from an SEC ALJ's authority. For instance, an FDIC ALJ is required to issue a "recommended decision," not an "Initial Decision." *See* 12 C.F.R. § 308.38. FDIC ALJs are required to submit their "recommended decision" with the record of the proceeding to the Executive Secretary of the FDIC who then forwards the complete record to the FDIC's Board of Directors. *Id.* The FDIC's rules do not provide for petitions for review, instead a party can file an exception to the recommended decision, but an exception is not required to be filed if the party had an opportunity to raise the objection or issue before the administrative law judge. *Id.* § 308.39. The Board of Directors of the FDIC then renders its final decision based on a review of the entire record. *Id.*§ 308.40. In contrast, the SEC does not review and render its own decision after a review of the record of every case and, in those instances, an Initial Decision becomes the final decision of the Commission. Thus, on the facts, an SEC ALJ's authority is much different from an FDIC ALJ and more like the STJ in *Freytag*.

[7] *See* www.sec.gov/alj/aljdec/aljdecarchive/aljdecarc2014.shtml.

The Division simply overstates the significance of the *Landry* court's finding. The D.C. Circuit's decision concerned the ALJ at issue in that case and did not find that all federal ALJs are employees and not inferior Executive officers. As the Solicitor General of the Department of Justice wrote in opposition to Landry's cert petition argument that the D.C. Circuit's decision "will have a wide ranging effect on 'a class of judges numbering over 1,000" –

> That assertion considerably overstates the significance of the court of appeals' decision. The court's decision directly addresses the constitutional status only of the ALJ (one of the two administrative law judges employed by OTS and assigned by OFIA) who presided at the administrative hearing in this case. *The court of appeals did not purport to establish any categorical rule that administrative law judges are employees rather than "inferior Officers" for purposes of the Appointments Clause.* To the contrary, the court's analysis focuses on the role of a particular ALJ, and his relationship to higher agency authority, within a specific decision making structure.

Brief For Respondent In Opposition, *Landry v. F.D.I.C.*, No. 99-1916 (Aug. 28, 2000), at p. 7 (emphasis added), attached hereto as Exhibit 1. Therefore, as the Solicitor General argued, the *Landry* court's finding was specific to that case and did not apply to other federal ALJs.

Second, the Division relies on *Landry* for the proposition that the authority to issue a final decision is the determinative factor in deciding whether the SEC's ALJs are inferior officers. The Supreme Court in *Freytag*, however, rejected that very same argument as applied to STJs—

> The Commissioner reasons that special trial judges may be deemed employees in subsection (b)(4) cases because they lack 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 (emphasis added). In *Landry*, Judge Randolph submitted a concurring opinion disagreeing with the majority's finding that the FDIC ALJ was not an inferior officer. Judge Randolph's concurring opinion explains how the majority's opinion in *Landry* was contrary to the Supreme Court's ruling in *Freytag*—

> According to the majority opinion, the second difference between this case and *Freytag* is that here the ALJ can never render final decisions of the FDIC, whereas special trial judges could, in cases other than the sort involved in *Freytag*, render a final decision of the Tax Court. It is true that the Supreme Court relied on this consideration . . . . What the majority neglects to mention is that the Court clearly designated this as an alternative holding. The Court introduced its alternative holding thus: "Even if the duties of special trial judges [just described] were not as significant as we and the two courts have found them to be, our *conclusion* would be unchanged." 501 U.S. at 882, 111 S.Ct. 2631 (italics added). What "conclusion" did the Court have in mind? The conclusion it had reached in the preceding paragraphs-namely, that although special trial judges may not render final decisions, they are nevertheless inferior officers of the United States within the meaning of Article II, § 2, cl. 2.

Id. at 1142.

As Judge Randolph further explained, the FDIC ALJ was an inferior officer not only because that determination "follows from *Freytag,*" it follows "also from the Supreme Court's recognition that the role of the modern administrative law judge "is 'functionally comparable' to that of a judge." *Id.* at 1142 (quoting *Butz v. Economou*, 438 U.S. 478 (1978)). Judge Randolph compared the FDIC ALJ's authority to issue a recommended decision, which the FDIC reviewed *de novo*, to functions performed by federal magistrates assigned to conduct hearings and submit proposed findings and recommendations to a district judge. *Id.* (citing 28 U.S.C. § 636(b)(1)(B)). As Judge Randolph stated, "[n]onetheless, it has long been settled that federal magistrates are 'inferior Officers' under Article II . . ." *Id.* Judge Randolph's concurring opinion equally applies to the Division's argument here.

Even if the *Landry* majority was correct in that an FDIC ALJ is not an inferior executive officer because they cannot render a final decision, it does not lead to the same result here. As set forth above, there are significant differences between an SEC ALJ's Initial Decision and an FDIC ALJ's "recommended decision." Even under the majority decision in *Landry,* SEC

ALJs are inferior officers because Initial Decisions become the final decision of the Commission when the Commission does not review the underlying proceedings.

Furthermore, although the Supreme Court has never directly addressed the issue of whether ALJs under the APA are inferior officers, in addition to the STJ in *Freytag*, the Supreme Court has addressed the issue of adjudicators who share similar authority to an SEC ALJ and have found them to be officers even though their rulings were subject to review. In *Weiss v. United States*, 510 U.S. 163 (1994), two United States Marines appealed their convictions, arguing that the military judges who convicted them were appointed in violation of the Appointments Clause. Like the special trial judges in *Freytag* and the SEC ALJ in this case, the military judge's determination as to the facts and the sanction was not final until it was approved by the officer who convened the court-martial after a *de novo* review. *Id.* at 167-68 and 193 (Souter, J., concurring). The Supreme Court, however, held that military trial and appellate judges are officers of the United States. *Id.* at 170.

Ryder v. United States, 515 U.S. 177 (1995), concerned the civilian judges of the Court of Military Review. There, the Government argued that even though the civilian judges had not been appointed pursuant to the Appointments Clause, Ryder's conviction should be affirmed. The Supreme Court disagreed finding that even though the decision was reviewed by the military judges of the Court of Military Review (a higher and properly constituted tribunal), it was insufficient to deny relief and the Court reversed the convictions. *Id.* at 182, 187-88. Finally, in *Edmond v. United States*, 520 U.S. 651 (1997), the Supreme Court held that judges of the Coast Guard Court of Criminal Appeals were "inferior Officers of the United States." The Coast Guard judges in *Edmond* had no power to render a final decision. 520 U.S. at 665. Nevertheless, the

Supreme Court found that those judges were exercising significant authority on behalf of the United States. *Id.* at 666.

In sum, the fact that an SEC ALJ's Initial Decision can be reviewed by the Commission, and the Commission alone, is not determinative that an SEC ALJ's authority does not rise to the level of an inferior officer. Quite the contrary, it shows that SEC ALJs, given their significant authority, are inferior officers whose decisions are subject to review directly by the principal officers of the agency themselves. *See Edmond*, 520 U.S. at 663 ("[W]e think it evident that 'inferior officers' are officers whose work is directed and supervised at some level by others who were appointed by presidential nomination with the advice and consent of the Senate.")

3. The History of the ALJ System, The ALJs' Appointments, and The Placement of the ALJs within the Competitive Service System Are Irrelevant To Whether An SEC ALJ is an Inferior Officer.

The Division argues that the Commission should defer to Congress' longstanding judgment that ALJs are employees. The Division, however, fails to offer any support that Congress has ever explicitly provided such judgment—it has not.[8] The Division contends that SEC ALJs are not Officers because Congress, in enacting 5 U.S.C. § 3105, specified that it is the agency, not the President, the department heads, or the judiciary, that appoints ALJs. The statutory language used by Congress in 5 U.S.C. § 3105 is no different than the language used by Congress as to the appointment of PCAOB members, who were held to be inferior officers. S*ee Free Enterprise*, 561 U.S. at 484; 15 U.S.C. § 7211(e)(4)(A). The Division also argues that it is Congress' long-standing judgment that ALJs are employees and not inferior officers because ALJs are placed in the competitive service. The Division does not cite a single case where a

[8] Just like the Supreme Court has recognized, *see Butz*, 438 U.S. at 513, a Senate committee has declared that "In essence individuals appointed as [ALJs] hold a position with tenure very similar to that provided for federal judges under the Constitution." Administrative Law Judges-Civil Service, Senate Report 95-697, Legislative History of P.L. 95-251, 95th Congress, 1st Sess. 2 (1978) U.S. Code Cong. & Ad. News 496, 497.

court considered this factor in making a determination whether a government official is an inferior officer. In describing how the majority's opinion in *Free Enterprise* could affect other positions in the Federal Government, including those in the civil service, Justice Breyer noted in his dissent that–

> The "civil service" is defined by statute to include "all appointive positions in ... the Government of the United States," excluding the military, but including all civil "officer[s]" up to and including those who are subject to Senate confirmation. 5 U.S.C. §§ 2101, 2102(a)(1)(B), 2104. The civil service thus includes many officers indistinguishable from the members of both the Commission and the Accounting Board. Indeed, as this Court recognized in *Myers*, the "competitive service"—the class within the broader civil service that enjoys the most robust career protection—"includes a vast majority of all the civil officers" in the United States. 272 U.S., at 173, 47 S.Ct. 21 (emphasis added); 5 U.S.C. § 2102(c).

Free Enterprise, 561 U.S. at 537 (quoting 5 U.S.C. §§ 2101, 2102(a)(1)(B), 2104) (Breyer, J, dissenting). Thus, the fact that ALJs are in the competitive service is not evidence of a Congressional opinion that ALJs are "mere" employees rather than inferior officers. One need only review the APA to counter such an assertion in that Congress specifically created the ALJ position to exercise adjudicatory functions that would otherwise be exercised by the Commission or a number of the Commissioners themselves.

The Division also argues that it is telling that ALJs are subordinate to the employing agency on policy and interpretation of law. This fact would be significant in determining whether one is a principal officer as opposed to an inferior officer, but is irrelevant to whether SEC ALJs are inferior officers as opposed to "mere" employees. To be an inferior officer one necessarily must be subordinate to a principal officer within the agency. *Edmond*, 520 U.S. at 664 ("the term 'inferior officer' connotes a relationship with some higher ranking officer or officers below the President: whether one is an 'inferior' officer depends on whether he has a superior.")

C. Because SEC ALJs Are Inferior Officers And Are Protected By Two Layers of Good Cause Protection, The Underlying Administrative Proceeding Here Was Unconstitutional

The Supreme Court's decision in *Free Enterprise* applies directly to this matter and compels a finding that the SEC's administrative forum and the Initial Decision here are unconstitutional. The Court in *Free Enterprise* stated the following—

> We hold that such multilevel protection from removal is contrary to Article II's vesting of the executive power in the President. The President cannot "take Care that the Laws be faithfully executed" if he cannot oversee the faithfulness of the officers who execute them. Here the President cannot remove an officer who enjoys more than one level of good-cause protection, even if the President determines that the officer is neglecting his duties or discharging them improperly. That judgment is instead committed to another officer, who may or may not agree with the President's determination, and whom the President cannot remove simply because that officer disagrees with him. This contravenes the President's "constitutional obligation to ensure the faithful execution of the laws."

561 U.S. at 484. The above is exactly the situation here. An SEC ALJ is an inferior officer and can only be removed by proceedings initiated by the Commission for good cause and determined by the Merit Systems Protection Board. Members of the Merit Systems Protection Board and SEC Commissioners can only be removed "for inefficiency, neglect of duty, or malfeasance in office." *See* 5 U.S.C. 1202(d); *Free Enterprise*, 561 U.S. at 487. Thus, an SEC ALJ is protected from removal by at least two layers of good-cause tenure protection.

The Division argues that even if an SEC ALJ is an inferior officer that "[t]he Supreme Court has repeatedly held that the Constitution permits Congress to place reasonable restrictions on the removal of inferior officers." But, as the Supreme Court recognized in *Free Enterprise*, "in those cases, however, only one level of protected tenure separated the President from an officer exercising executive power." *Free Enterprise*, 561 U.S. at 495. Thus, the Division's reliance on those cases is inapplicable here where there are at least two layers of good-cause

tenure protection, which effectively makes ALJs unaccountable to the President. The Supreme Court in *Free Enterprise* explained that—

> A second layer of protection changes the nature of the President's review. Now the Commission cannot remove a Board member at will. The President therefore cannot hold the Commission fully accountable for the Board's conduct.
>
> ....
>
> That arrangement is contrary to Article II's vesting of the executive power in the President. Without the ability to oversee the Board, or to attribute the Board's failings to those whom he can oversee, the President is no longer the judge of the Board's conduct. He is not the one who decides whether Board members are abusing their offices or neglecting their duties. He can neither ensure that the laws are faithfully executed, nor be held responsible for a Board member's breach of faith. This violates the basic principle that the President "cannot delegate ultimate responsibility or the active obligation to supervise that goes with it," because Article II "makes a single President responsible for the actions of the Executive Branch."

Id. at 495-96 (quoting *Clinton v. Jones*, 520 U. S. 681, 712–713 (1997) (Breyer, J. , concurring in judgment). For the very same reason, the SEC's use of an ALJ, including the use of the ALJs in the underlying proceedings here, is unconstitutional.

The Division goes on to argue that the Supreme Court's ruling in *Free Enterprise* concerned the sheltering of an entire independent sub-agency with expansive powers to govern an entire industry and did not 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. Nowhere in the Supreme Court's majority opinion did the Court limit the holding to instances concerning an independent sub-agency. Rather, the Court held that "dual for-cause limitations on the removal of board members contravene the Constitution's separation of powers." *Id.* at 491. The Court's ruling could hardly be clearer that dual for-cause protections of inferior officers violate the Constitution.

The Division's other arguments equally fail. First, the Division argues that because Congress gave the SEC discretion to use or not use ALJs, and it is the SEC who has chosen to use ALJs, this does not affect an abrogation of executive power. It is Congress, however, that created the position of ALJ and mandates that the SEC use ALJs unless the Commission itself or its members adjudicate administrative actions. Thus, unless the Commission or individual members of the Commission choose to preside over every administrative action, Congress mandates that the Commission use ALJs. Further, the fact that the Commission could chose not to use ALJs at all, is no different than the situation in *Free Enterprise*, where the SEC "could relieve the Board of any responsibility to enforce compliance with any provision of the Act, the securities laws, the rules of the Board, or professional standards." 15 U.S.C. § 7217(d)(1); *Free Enterprise*, 561 U.S. at 504 (noting that the SEC has the power "to relieve the Board of authority").

Second, the Division's argument that the authority exercised by SEC ALJs does "not rise to the level of core executive authority" is simply inaccurate. SEC ALJs preside over hearings in which they adjudicate enforcement matters brought by the Commission, as such they exercise Executive authority. *See Kuretski v. C.I.R.*, 755 F.3d 929 (D.C. Cir. 2014) (stating that "Tax Court, in our view exercises Executive authority as part of the Executive Branch"). Furthermore, SEC ALJ's exercise Executive authority that otherwise would be exercised by the principal officers of the Commission. Justice Scalia in his concurring opinion in *Freytag*, joined by three other members of the Court, stated—

> Today, the Federal Government has a corps of administrative law judges numbering more than 1,000, whose principal statutory function is the conduct of adjudication under the Administrative Procedure Act (APA), see 5 U.S.C. §§ 554, 3105. They are all *executive* officers. "Adjudication," in other words, is no more an

> "inherently" judicial function than the promulgation of rules governing primary conduct is an "inherently" legislative one.

Id. at 910 (Scalia, J., concurring opinion).[9]

Third, the Division argues that because the Commission has ultimate authority over administrative proceedings, the Commission exercises significant control over SEC ALJs. The fact that the Commission can, if it chooses to, review an ALJ's Initial Decision, does not make an ALJs' rulings and authority any less significant. Furthermore, this very same argument was raised in *Free Enterprise* and the Court stated—

> Alternatively, respondents portray the Act's limitations on removal as irrelevant, because—as the Court of Appeals held—the Commission wields "at-will removal power over Board functions if not Board members." The Commission's general "oversight and enforcement authority over the Board," §7217(a), is said to "blun[t] the constitutional impact of for-cause removal," and to leave the President no worse off than "if Congress had lodged the Board's functions in the SEC's own staff," PCAOB Brief 15.
>
> Broad power over Board functions is not equivalent to the power to remove Board members.

Id. at 502-04 (internal citations omitted).

The Division also seeks to distinguish the PCAOB from an SEC ALJ by arguing that certain activities of the PCAOB were outside of the SEC's controls. But that is the case here as well in that the SEC only conducts a *de novo* review where there is a showing of prejudicial error, a clearly erroneous conclusion or finding of fact, or an important exercise of discretion or decision of law or policy that is important and that the Commission should review. If the Commission does not hear an appeal of an ALJ Initial Decision, the ALJ's Initial Decision will

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[9] Further, the Supreme Court's decision in *Edmond*, *Weiss* and *Ryder* concerned officers performing adjudicative functions as military judges and it was never suggested in those cases that they were not Executive officers.

become the final decision of the Commission. Even if reviewed by the Commission, the Commission grants substantial deference to the ALJ's findings of credibility.

Fourth, the Division argues that PCAOB members enjoyed greater tenure protection than ALJs. Although the Supreme Court in *Free Enterprise* recognized the PCAOB's tenure protection, its decision did not turn on the specifics of the PCAOB's tenure protection, but on the fact that the PCAOB Board members enjoyed two levels of "good-cause" tenure protection. *Id.* at 502. Furthermore, it is far from clear that a PCAOB board member enjoyed greater tenure protection than SEC ALJs. Congress provided for term limits for PCAOB board members (five years), but there are no such term limits on ALJs. *See* 5 C.F.R. § 930.204; 15 U.S.C. § 7211(e)(5)(b).

Finally, the fact that the Executive Branch has used tenure-protected ALJs for nearly seventy years does not establish a "gloss" on the Constitution that supports the current framework. The Division does not offer any support for the assertion that a constitutional infirmity can somehow be "glossed" over because it has been the practice for a certain number of years. That is simply not the law. Such a rule would tear away at the very fabric of the Constitution. Furthermore, the Respondents' separation of powers argument does not invalidate the use of ALJs altogether in the federal system. Rather, it invalidates the current structure and authority of the SEC's ALJs because of the significant authority they exercise and because they remain unaccountable to the President.

IV. CONCLUSION

For the reasons discussed above and in Respondents' petitions, as detailed in their Appeals, all charges should be dismissed, and the relief requested by the Division should be denied.

This 23rd day of February, 2015.

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No. 99-1916

In the Supreme Court of the United States

MICHAEL D. LANDRY, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the decision of the Federal Deposit Insurance Corporation, which ordered that petitioner should be removed from his position as a bank officer and prohibited from further participation in the banking industry, should be set aside on the ground that the administrative law judge who conducted a hearing and issued a recommended decision was appointed in an unconstitutional manner.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-39a) is reported at 204 F.3d 1125. The final order of the Federal Deposit Insurance Corporation (FDIC) Board of Directors (Pet. App. 40a-108a) is reported at 1 FDIC Enforcement Decisions and Orders ¶ 5256, at A-3017. The order of the FDIC Board of Directors denying petitioner's motion for stay pending review in the court of appeals is reported at 1 FDIC Enforcement Decisions and Orders ¶ 5259, at A-3053, WL 639568. The recommended decision of the Administrative Law Judge (Pet. App. 109a-222a) is reported at 1 FDIC Enforcement Decisions and Orders ¶ 5256, at A-3044.

JURISDICTION

The judgment of the court of appeals was entered on March 3, 2000. The petition for a writ of certiorari was filed on May 31, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Congress has authorized the Federal Deposit Insurance Corporation to remove a bank officer from his position and to prohibit him from further participation in the banking industry when his actions threaten the integrity or stability of an insured bank. 12 U.S.C. 1818(e). An officer who has been notified of the FDIC's intention to remove and prohibit him from such participation may request an administrative hearing. 12 U.S.C. 1818(e)(4). If the officer requests a hearing, the FDIC assigns the case to an administrative law judge (ALJ) from the Office of Financial Adjudications (OFIA) for a formal, on-the-record administrative hearing. 12 U.S.C. 1818(e)(4) and (h)(1); 5 U.S.C. 554, 556; 12 C.F.R. 308.103.

In 1989, Congress directed the federal banking agencies to "establish their own pool of administrative law judges" to conduct hearings. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, § 916, 103 Stat. 486 (12 U.S.C. 1818 note). Pursuant to that authority, the banking agencies established the OFIA. Pet. App. 96a-97a, 207a. One of the federal banking agencies, the Office of Thrift Supervision (OTS)—an agency within the Department of the Treasury, see 12 U.S.C. 1462a(a)—employed two ALJs for OFIA assignment. Pet. App. 95a n.36, 96a-97a, 207a-208a. Those ALJs had previously been certified as qualified by the Office of Personnel Management. See *id.* at 211a-212a n.3, 217a.

At the conclusion of the hearing, the ALJ issues a recommended decision and refers the matter to the FDIC Board of Directors for a formal and final decision. 12 C.F.R. 308.38. The FDIC Board reviews the administrative record de novo, considers any exceptions filed by either party (the bank officer or FDIC Enforcement Counsel), and issues a final decision and order. 12 U.S.C. 1818(h)(1); 12 C.F.R. 308.39, 308.40. If the FDIC Board issues an order removing the officer and/or prohibiting him from further participation in the industry, the officer may file a petition for review "in the court of appeals of the United States for the circuit in which the home office of the depository institution is located, or in the United States Court of Appeals for the District of Columbia Circuit." 12 U.S.C. 1818(h)(2).

2. Petitioner was the Chief Financial Officer, Senior Vice President, and Cashier of the First Guaranty Bank of Hammond, Louisiana (Bank). Pet. App. 2a. In 1990, the FDIC ordered the Bank to increase its capital, and the FDIC subsequently threatened to terminate the Bank's deposit insurance due to its dangerously low capital level. *Id.* at 3a-4a. Petitioner and two of his associates, also officers or senior managers of the Bank, devised a scheme to enhance the Bank's capital and acquire a controlling interest in it without investing any of their own funds. *Id.* at 2a-4a, 8a-50a. That scheme, which they called the "Pangaea Plan," involved the formation of a holding company that would acquire 80% of the Bank's outstanding stock and sell 30% of the holding company's stock to investors. *Id.* at 4a, 51a. Petitioner and his cohorts planned to keep 70% of the holding company's stock for themselves without paying for it. *Id.* at 4a, 51a-52a. To promote their scheme, petitioner and the others traveled internationally at the Bank's expense; they also caused the Bank to pay for

expensive service contracts and to make poorly underwritten loans to potential investors in their plan. *Id.* at 5a-6a, 51a-64a. Petitioner's activities provided little or no benefit to the Bank and caused the Bank to lose hundreds of thousands of dollars at a time when it could least afford it. *Id.* at 5a-6a, 25a-31a, 77a-79a.

3. On April 30, 1996, the FDIC issued a notice of its intent to remove petitioner from the Bank and prohibit him from further participation in the banking industry. Pet. App. 2a, 40a. One of the two OFIA ALJs was assigned to conduct an administrative hearing in the case. See *id.* at 2a-3a, 42a, 97a, 109a-110a, 207a-208a. The ALJ conducted a two-week evidentiary hearing and subsequently issued a decision recommending that petitioner be removed from the Bank and prohibited from further participation in the banking industry. See *id.* at 2a-3a, 42a, 109a-220a.

On May 25, 1999, the FDIC Board of Directors issued its Final Decision and Order, in which it found that grounds existed under 12 U.S.C. 1818(e) to remove petitioner from his position and prohibit him from further participation in the banking industry. Pet. App. 101a, 40a-108a. The Board made clear that it "ha[d] reviewed the record in its entirety" and "ha[d] adopted the ALJ's findings of fact and conclusions of law because they are supported by the preponderance of the evidence." *Id.* at 48a, 92a-93a.[1] Petitioner then requested review by the court of appeals.

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[1] In his submissions to the Board, petitioner contended, *inter alia*, that "the OTS's hiring of [the ALJ] and OFIA's assignment of him to this matter were unconstitutional" because "the OTS, the FDIC and OFIA are constitutionally disabled from appointing any employees who might be regarded as 'inferior officers.'" Pet. App. 96a. The Board rejected that contention, noting that "Congress has, in many instances and for many years, vested in non-Cabinet

4. The court of appeals denied the petition for review. Pet. App. 1a-39a. Petitioner contended, *inter alia*, that the Board's removal order was invalid because the ALJ who had heard the evidence and issued a recommended decision was an "inferior Officer" who had not been appointed in conformity with the Appointments Clause of the Constitution, Article II, Section 2, Clause 2. The court rejected that contention. Pet. App. 12a-16a. The court explained that the ALJ involved in petitioner's case was an employee rather than an inferior officer because the ALJ exercised "purely recommendatory powers" and had no authority to issue a final decision in any case. *Id.* at 16a; see also *id.* at 7a-8a ("The FDIC itself determined [petitioner's] responsibility after reviewing the ALJ's recommended decision de novo."); *id.* at 14a (explaining that "[f]inal decisions are issued only by the FDIC Board of Directors" and that "the FDIC Board makes its own factual findings").[2]

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agencies the authority to appoint inferior officers." *Ibid.* The Board explained that in FIRREA, "Congress directed the federal banking agencies to hire ALJs," and that the agencies have "agreed to share ALJs who, as an administrative matter, would be hired by OTS." *Ibid.* The Board concluded that

> pursuant to FIRREA, Congress, within its discretion, directed that the federal banking agencies establish a pool of ALJs to preside in administrative enforcement proceedings. To that end, the agencies established OFIA to oversee the work of the ALJ thus employed by OTS, and through which the banking agencies have the use of a "pool" of ALJs. Accordingly, the ALJ in this case was validly appointed within the meaning of the Appointments Clause.

Id. at 96a-97a.

[2] As we explain above (see note 1, *supra*), the FDIC Board concluded that even if the ALJ in this case was an inferior officer, his hiring by OTS and his assignment by OFIA were consistent

The court of appeals distinguished this Court's ruling in *Freytag* v. *Commissioner*, 501 U.S. 868 (1991), which held that special trial judges (STJs) of the United States Tax Court are "inferior Officers" within the meaning of the Appointments Clause. The court of appeals explained that *Freytag* was not controlling because STJs (unlike the ALJ at issue here) are authorized to issue final decisions in certain categories of cases. See Pet. App. 14a-16a.

The court of appeals also rejected petitioner's contention that the FDIC had improperly refused to produce certain documents that he needed for his defense, and had improperly invoked the deliberative process and law enforcement privileges. Pet. App. 16a-23a. The court held as well that the Board's removal order was supported by substantial evidence. *Id.* at 24a-31a. It stated, in that regard, that petitioner's "use of Bank funds * * * in pursuit of breathtakingly irresponsible schemes" had exposed the Bank to "an undue and abnormal risk of insolvency." *Id.* at 26a.

Judge Randolph filed a separate opinion concurring in part and concurring in the judgment. Pet. App. 31a-39a. Judge Randolph concluded that "[t]here are no relevant differences between the ALJ in this case and the special trial judge in *Freytag*," *id.* at 33a, and that the ALJ was therefore properly regarded as an inferior officer, *id.* at 33a-37a. Judge Randolph stated, however, that "[g]iven the FDIC's *de novo* review and the majority's thorough rejection of [petitioner's] various claims of error," petitioner had "suffered no prejudice" as a result of the purported Appointments Clause violation. *Id.* at 38a. He therefore agreed with the ma-

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with the Appointments Clause. The FDIC did not press that argument in the court of appeals.

jority that the petition for review of the FDIC's final order should be denied. *Id.* at 39a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is not warranted.

1. Petitioner contends (Pet. 9) that the panel decision will have a wide ranging effect on "a class of judges numbering more than 1,000." That assertion considerably overstates the significance of the court of appeals' decision. The court's decision directly addresses the constitutional status only of the ALJ (one of the two administrative law judges employed by OTS and assigned by OFIA) who presided at the administrative hearing in this case. The court of appeals did not purport to establish any categorical rule that administrative law judges are employees rather than "inferior Officers" for purposes of the Appointments Clause. To the contrary, the court's analysis focuses on the role of a particular ALJ, and his relationship to higher agency authority, within a specific decision-making structure.

2. The Appointments Clause of the Constitution states that the President

> shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: 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. The "Officers of the United States" to which the Appointments Clause refers include "any appointee exercising significant authority pursuant to the laws of the United States." *Buckley* v. *Valeo*, 424 U.S. 1, 126 (1976). The term does not, however, encompass "employees of the United States," who are "lesser functionaries subordinate to officers of the United States." *Id.* at 126 n.162.

As the court of appeals correctly held, the ALJ who conducted the administrative hearing in this case is properly regarded as an employee rather than an "inferior Officer." Contrary to petitioner's contention (Pet. 11), the ALJ does not "perform adjudicatory functions otherwise those of agency heads." Any decision to remove and prohibit a bank officer must be made by the FDIC Board of Directors. 12 U.S.C. 1818(e)(4) and (h)(1). Pursuant to FDIC regulations, the ALJ is charged with producing only a "recommended decision, recommended findings of fact, recommended conclusions of law, and [a] proposed order." 12 C.F.R. 308.38(a). The FDIC Board of Directors renders a final decision and order after conducting a de novo review of the entire administrative record. 12 U.S.C. 1818(e)(4) and (h)(1); 12 C.F.R. 308.40(c).

Under no circumstances can the ALJ render the final decision of the FDIC. In the course of rendering its decision, moreover, the Board makes its own factual findings and does not accord deference to the findings of the ALJ. 12 U.S.C. 1818(h)(1); 12 C.F.R. 308.40(c); see also *In re Landry*, FDIC-95-65e, 1999 WL 639568, at *1 (FDIC July 8, 1999) (denying petitioner's request for a stay pending review in the court of appeals, and noting that the FDIC had given petitioner's case "an exhaustive de novo review"). Thus, the ALJ's role within the FDIC's decisionmaking scheme belies the

contention that the ALJ "exercis[es] significant authority pursuant to the laws of the United States." *Buckley*, 424 U.S. at 126.

Petitioner principally relies (Pet. 12-15) on *Freytag* v. *Commissioner*, 501 U.S. 868 (1991), in which this Court held that special trial judges (STJs) of the Tax Court are "inferior Officers" rather than employees for purposes of the Appointments Clause. The ALJ in this case, however, differs in important respects from the STJs at issue in *Freytag*. Most significantly, STJs are authorized to render final decisions in declaratory judgment proceedings and limited-amount tax cases pursuant to 26 U.S.C. 7443A(b)(1)-(3). See 501 U.S. at 873, 882. This Court held that the STJs' authority to render final decisions in those categories of cases required that they be treated as inferior officers for all purposes. See *id.* at 882 ("The fact that an inferior officer on occasion performs duties that may be performed by an employee not subject to the Appointments Clause does not transform his status under the Constitution."). Because the ALJ involved in the present matter is not empowered to issue a final decision in *any* type of case, that portion of the *Freytag* Court's analysis is altogether inapplicable here.

As the concurring judge in the court of appeals emphasized (see Pet. App. 35a-36a), one paragraph of the *Freytag* opinion suggests that STJs function as "inferior officers" even with respect to cases under 26 U.S.C. 7443A(b)(4), in which the STJ lacks authority to issue a final decision. The *Freytag* Court stated:

> The Commissioner reasons that special trial judges may be deemed employees in subsection (b)(4) cases because they lack 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. 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 a 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.

501 U.S. at 881-882 (citations omitted).

Even with respect to that aspect of the *Freytag* Court's analysis, however, the ALJ here differs significantly from a Tax Court STJ. The ALJ at issue in this case lacks "the power to enforce compliance with discovery orders" (501 U.S. at 882), since he is not vested with contempt powers. Rather, an aggrieved party must apply to a United States District Court for enforcement of a subpoena issued by the ALJ. See 12 C.F.R. 308.25(h), 308.26(c), 308.28(d), 308.34(c). Moreover, even in those cases that the STJ lacks final authority to decide, the STJ's factual findings are reviewed by the Tax Court under a deferential standard. See Pet. App. 14a; *Freytag*, 501 U.S. at 874 n.3. The FDIC, by contrast, accords no deference to the ALJ's findings of fact. See Pet. App. 14a; pp. 8-9, *supra*.[3]

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[3] Petitioner's attempt (see Pet. 10-11) to analogize the ALJ to a federal district court or magistrate judge is similarly misconceived.

Petitioner also relies (Pet. 15, 16) on *Weiss* v. *United States*, 510 U.S. 163 (1994), and *Edmond* v. *United States*, 520 U.S. 651 (1997), which held that military trial and appellate judges are inferior officers. Petitioner's reliance on those decisions is misplaced. The military trial judges at issue in *Weiss* "rule[] on all legal questions, and instruct[] court-martial members regarding the law and procedures to be followed." 510 U.S. at 167. The trial judge may also render the final decision in a case with the consent of the accused. See Art. 16(1)(B) and (2)(C) of the Uniform Code of Military Justice (UCMJ), 10 U.S.C. 816(1)(B) and (2)(C); Art. 51(d), UCMJ, 10 U.S.C. 851(d); *Weiss*, 510 U.S. at 168. And while the court-martial's findings and sentence are subject to review in any case in which the accused is convicted (see Pet. 15), "the United States may not appeal an order or ruling that is, or that amounts to, a finding of not guilty with respect to the charge or specification." Art. 62(a)(1), UCMJ, 10 U.S.C. 862(a)(1) (1994 & Supp. IV 1998). The court-martial's decision is therefore final and unreviewable in a significant category of cases.

Edmond is also distinguishable. The military appellate judges at issue in *Edmond* render final decisions in cases in which the Judge Advocate General declines to invoke the jurisdiction of the Court of Appeals for the Armed Forces (CAAF) and the CAAF denies the defendant's request for discretionary review. See Art. 66(a), UCMJ, 10 U.S.C. 866(a); *Edmond*, 520 U.S. at 664-665. And even where the CAAF does exercise jurisdiction, it reviews the factual findings of the inter-

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District judges routinely decide contested cases, and magistrate judges are authorized, with the consent of the parties, to make final dispositions of a variety of matters. See 28 U.S.C. 636.

mediate court under a deferential standard. See *id.* at 665.[4]

3. In conducting judicial review under the Administrative Procedure Act, a court "shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error." 5 U.S.C. 706. Courts are generally reluctant to set aside agency action unless "the party asserting error [can] demonstrate prejudice from the error." *DSE, Inc.* v. *United States*, 169 F.3d 21, 31 (D.C. Cir. 1999) (quoting *Air Canada* v. *Department of Transp.*, 148 F.3d 1142, 1152 (D.C. Cir. 1998)). Petitioner does not contest the court of appeals' determination that the FDIC's decision in this case was supported by substantial evidence. Indeed, as the court of appeals observed, the FDIC Board's most compelling evidence came from petitioner himself. See Pet. App. 6a, 28a, 38a n.4.

Even assuming *arguendo* that the ALJ was not appointed in conformity with the Appointments Clause,

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[4] In concluding that judges on the Coast Guard Court of Criminal Appeals are "inferior" rather than "principal" officers, the Court in *Edmond* observed that those judges "have no power to render a final decision on behalf of the United States *unless permitted to do so by other Executive officers.*" 520 U.S. at 665 (emphasis added). The underscored language reflects the fact that the CAAF must review any case that the Judge Advocate General directs it to hear, and may review any other case "upon petition of the accused." See *ibid.* (quoting Art. 67(a), UCMJ, 10 U.S.C. 867(a)). But while decisions of the Court of Criminal Appeals are subject to further review at the discretion of Executive Branch officials, that court nevertheless renders the ultimate decision in numerous cases where the Judge Advocate General does not invoke the CAAF's jurisdiction and the CAAF denies the defendant's petition for review. Petitioner's description of the case omits the underscored language. See Pet. 16.

such a deficiency would not provide a basis for invalidating the order that is before this Court. The decision under review is a decision of the FDIC Board, not a decision of the ALJ. See 12 U.S.C. 1818(e), (h)(1) and (h)(2). As explained above, the ALJ simply presented the Board with recommendations. The decision from which petitioner seeks relief was issued by the Board itself, which engaged in de novo review of petitioner's legal and factual claims; the ALJ's recommendation had no more than persuasive force and did not constrain the Board's discretion in any way. Because the ALJ's recommendation is neither the cause of petitioner's legal disabilities nor the subject of the current review proceeding, any defect in the ALJ's selection would not provide a basis for setting aside the order of the Board.

In *Ryder* v. *United States*, 515 U.S. 177, 186-188 (1995), this Court held that a constitutional infirmity in the method of selection of judges on the Coast Guard Court of Military Review (now called the Court of Criminal Appeals) was not rendered harmless by the availability of further review in the Court of Military Appeals (now called the CAAF). Petitioner relies (Pet. 16) on *Ryder* as support for the proposition that "the FDIC Board's *de novo* review does not cure the constitutional violation in the instant case." In *Ryder*, however, the Court emphasized that while the Courts of Military Review "exercise *de novo* review over the factual findings and legal conclusions of the court-martial," the Court of Military Appeals applies a narrower standard of review and will affirm a judgment of conviction "so long as there is some competent evidence in the record to establish the elements of an offense beyond a reasonable doubt." *Ryder*, 515 U.S. at 187. The Court concluded:

> Examining the difference in function and authority between the Coast Guard Court of Military Review and the Court of Military Appeals, it is quite clear that the former had broader discretion to review claims of error, revise factual determinations, and revise sentences than did the latter. It simply cannot be said, therefore, that review by the properly constituted Court of Military Appeals gave [the defendant] all the possibility for relief that review by a properly constituted Coast Guard Court of Military Review would have given him.

Id. at 187-188. Here, by contrast, the FDIC issues its own decision and accords no deference to the findings of the ALJ. There is consequently no basis for concluding that any defect in the manner of the ALJ's selection prejudiced petitioner or deprived him of any substantive protection guaranteed by law.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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