

HARD COPY

UNITED STATES OF AMERICA

**Before the
SECURITIES AND EXCHANGE COMMISSION**

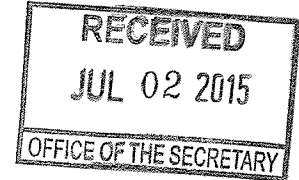
ADMINISTRATIVE PROCEEDING

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. :
:



**THE DIVISION OF ENFORCEMENT'S MEMORANDUM OF LAW IN RESPONSE TO
THE COMMISSION'S MAY 27, 2015 ORDER REQUESTING SUPPLEMENTAL
BRIEFING**

Andrew J. Ceresney
Director, Division of Enforcement
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

On May 27, 2015, the Commission issued an order directing the Division of Enforcement (“Division”) to file and serve on Respondents an affidavit and any supporting materials “setting forth the manner in which ALJ Cameron Elliot and Chief ALJ Brenda Murray were hired, including the method of selection and appointment.” Order Requesting Additional Submissions and Briefing, Investment Advisers Act Release No. 4096 at 1 (May 27, 2015). The May 27 order also directed the parties to file supplemental briefs addressing (1) whether, assuming “solely for the sake of argument” that Commission ALJs who presided over Respondents’ administrative hearing are “inferior officers” within the meaning of Article II, Section 2, Clause 2 of the Constitution, “their manner of appointment violates the Appointments Clause;” and (2) “the appropriate remedy if such a violation [were] found.” *Id.* at 2. The Division submitted a Notice of Filing and Affidavit containing the factual information the Division believes legally relevant to resolving Respondents’ Article II-based constitutional claims based on this assumption—namely that, consistent with his status as an agency employee and not a constitutional officer, ALJ Elliot was not hired with the approval of the individual members of the Commission.

The Division now files this response to the Commission’s request for additional briefing on Respondents’ Appointments Clause challenge. In response to the Commission’s first question, “assuming solely for the sake of argument that Commission ALJs” who presided over Respondents’ administrative hearing are ““inferior officers’ within the meaning of Article II, Section 2, Clause 2 of the Constitution,” the Division believes that their manner of appointment would be inconsistent with the terms of the Appointments Clause. But it is the Division’s view that ALJ Elliot’s hiring did not violate the Appointments Clause of the Constitution because Commission ALJs are mere employees and not inferior officers under the Constitution. As

presented in the Division's February 11, 2015 Brief (at 1-8), Commission ALJs are mere employees because the Commission retains plenary authority over all aspects of administrative proceedings and Commission ALJs have only limited power. The Commission should therefore follow the holding of the D.C. Circuit in *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000), the only court of appeals to have decided the constitutional status of ALJs, where the court found that agency ALJs with the same limited authority as Commission ALJs are employees, not constitutional officers.¹ In response to the Commission's second question, the Division strongly urges the Commission to refrain from fashioning a fix for a non-existent constitutional violation. Rather, and for the additional reasons explained below, the Commission should find that ALJ Elliot was hired in a manner consistent with Article II, Section 2, Clause 2 of the Constitution because he is an employee, and not a constitutional officer, and that there is therefore no Appointments Clause defect to remedy.

**THE COMMISSION SHOULD DEFER TO THE SCHEME CONGRESS ESTABLISHED FOR THE
HIRING OF ALJs AS EMPLOYEES NOT CONSTITUTIONAL OFFICERS**

Counseling against the imposition of any remedy here is the 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. 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 “[t]hat constitutional assignment to Congress counsels judicial deference,” *In re Sealed Case*, 838 F.2d 476, 532 (D.C.

¹ *See* February 11, 2015 Brief at 6-8 (applying *Landry* and distinguishing Commission ALJs from special trial judges in *Freytag v. Comm'r*, 501 U.S. 868 (1991)).

Cir.) (Ginsburg, J., dissenting), *rev'd sub nom. Morrison v. Olson*, 487 U.S. 654 (1988).² When Congress created the modern ALJ in 1946, *see* § 11 of the APA, Pub. L. No. 79-404, 60 Stat. 237, 244 (1946), the method of appointment generally determined the status—employee or officer—of the position. At that time, it was the Supreme Court’s “well established” view that whether one was “an officer of the United States” was dependent on the method of appointment itself; only those who had been appointed “by the president, or of one of the courts of justice or heads of departments authorized by law to make such an appointment” were officers, while others were mere employees. *United States v. Mouat*, 124 U.S. 303, 307 (1888). Congress has demonstrated that it knows how to comply with the Appointments Clause when creating inferior officer positions. *See* 5 U.S.C. § 2104(a)(1) (defining “officer” for certain statutory purposes, in part, on the basis of whether the individual is “required by law to be appointed” by the President, a court of the United States, the head of an Executive agency, or the Secretary of a military department); *see also, e.g., Morrison*, 487 U.S. 654 (independent counsel—who Congress specified must be appointed by a special panel of judges pursuant to 28 U.S.C. § 49—is an “inferior officer”); *Kalaris v. Donovan*, 697 F.2d 376, 396 (D.C. Cir. 1983) (Department of Labor’s Benefits Review Board members “appointed by the Secretary” pursuant to 33 U.S.C. § 921 “are inferior officers of the United States”). Yet Congress specified in the APA that it is the “agency”—not the President, the department head, or a court of law—that appoints ALJs (Pub. L. No. 79-404, 60 Stat. 237, 244; *see* 5 U.S.C. § 3105), indicating that Congress did not

² Of course, as then-Judge Ginsburg noted in her dissenting opinion in *In re Sealed Case*, Congress’s “intention [as reflected in the chosen mode of appointment] alone is not dispositive of the constitutional issue, for it is common ground that Congress does not have the final say.” 838 F.2d at 532 (internal quotation marks omitted). But “judicial review must fit the occasion,” and in a “debatable” case, “the fully rational congressional determination” merits acceptance. *Id.*

view ALJs as inferior officers.³ In the seven decades since the ALJs' creation, Congress has not changed ALJs' method of appointment (except in rare situations unique to an agency).

The history of the ALJ position confirms that Congress has never considered ALJs to be constitutional officers. Prior to the passage of the APA, administrative hearing examiners, like other government employees of that period, were dependent on their agency's ratings for compensation and promotion. In 1946, as a result of complaints about the examiners' perceived partiality, Congress enacted the APA and "separat[ed] adjudicatory functions and personnel from investigative and prosecution personnel in the agencies," by placing hearing examiners under the jurisdiction of the Civil Service Commission in a merit-based civil service system for federal employees, and by vesting the Civil Service Commission with control of the ALJs' compensation, promotion, and tenure. *Ramspeck v. Fed. Trial Exam'rs Conference*, 345 U.S. 128, 131 (1953). In enacting these measures, Congress gave no indication that it meant to elevate ALJs' status above that of the investigative and prosecution personnel of the agency. To the contrary, Congress explicitly "retained the examiners as classified Civil Service employees." *Id.* at 133.

Today OPM administers the process by which ALJs are screened for positions across federal agencies. By law, OPM administers the competitive examination for selecting all ALJs across the federal government (5 U.S.C. §§ 1104, 1302; 5 C.F.R. § 930.201(d)-(e)) and has the authority to define and revise criteria governing eligibility for ALJ service (*Friedman v. Devine*, 565 F. Supp. 200, 203 (D.D.C. 1982), *aff'd* 711 F.2d 420 (D.C. Cir. 1983); 5 U.S.C. § 1305; 5

³ Although the Commission's organic statutes provide that "hearings . . . may be held before . . . any officer or officers of the Commission," *e.g.*, 15 U.S.C. § 78v, there is no indication that Congress intended the term "officers of the Commission" to be synonymous with "Officers of the United States," U.S. Const. art. II, § 2, cl. 2, for purposes of the Appointments Clause. Indeed, when providing that ALJs conduct administrative hearings in the Administrative Procedure Act, Congress referred to ALJs as "presiding employees," *see* 5 U.S.C. § 556(b).

C.F.R. § 930.201(e)(3)). OPM also oversees each agency's "decisions concerning the appointment, pay, and tenure" of ALJs. 5 C.F.R. § 930.201(e)(2); *see also* 5 U.S.C. § 5372. Congress has also specified precise mechanisms by which adverse employment actions must proceed against ALJs, 5 U.S.C. § 7521.

The fact that Commission ALJs are employees is confirmed by this comprehensive scheme governing the hiring and employment of ALJs, which Congress and OPM together have developed and implemented through myriad statutory and regulatory provisions, and which stands in stark contrast to Congress's statutory directives instructing that certain officers must be appointed "by the president, or of one of the courts of justice or heads of departments authorized by law to make such an appointment." *Mouat*, 124 U.S. at 307; *see, e.g., Morrison*, 487 U.S. 654; *Kalaris*, 697 F.2d at 396. This well-developed process for hiring and appointing ALJs across the federal government is no accident requiring rectification; rather, it is consistent with Congress's long-standing judgment that ALJs are not inferior officers.

NO REMEDY IS WARRANTED

As is evident from the Division's earlier filing, ALJ Elliot was not hired in a manner that would satisfy the Appointments Clause if he were a constitutional officer. That is not a bureaucratic oversight; nor does it demonstrate constitutional infirmity. Rather, it is a product of the statutory and regulatory scheme that Congress designed to protect ALJ impartiality. This process was established to ensure that ALJs "were not to be paid, promoted, or discharged at the whim or caprice of the agency or for political reasons." *Ramspeck*, 345 U.S. at 142. This process treats ALJs as employees, not officers, and their hiring is consistent with that status. Because there is no constitutional violation under the Appointments Clause, there is no basis for a "remedy." If, however, the Commission holds that SEC ALJs are inferior officers and that

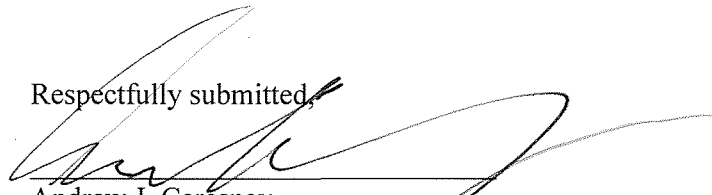
their hiring violated the Appointments Clause because they were not hired with the approval of the Commissioners, the Division requests that it be permitted to submit additional briefing about components of any appropriate remedy, such as ratifying SEC ALJs' prior hiring. To be clear, the Division does not seek any remedy, including as an alternative measure, at this juncture. Because of the potential ramifications of such a remedy⁴ and because Congress has set out a scheme, implemented by OPM, for the hiring of these employees, the Division believes that any Commission efforts to superimpose on this scheme a remedy to rectify a problem that does not exist is inadvisable at this time.

CONCLUSION

For the foregoing reasons, the Commission should reject Respondents' Appointments Clause claim on the ground that Commission ALJs are employees, not inferior officers, and in turn, should not undertake to appoint these ALJs as inferior officers.

This 1st day of July, 2015.

Respectfully submitted,



Andrew J. Ceresney
Director, Division of Enforcement
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

⁴ Such a remedy is not only unnecessary but also fails to resolve the ongoing litigation before the Commission and in district courts around the country given the other constitutional claims raised in this case and others that would not be addressed by such action. Further, it seems likely to prompt new issues in litigation, whether in this case or others.

CERTIFICATE OF SERVICE

The undersigned counsel for the Division of Enforcement hereby certifies that he has served or arranged for service of the foregoing document on the following this 1st day of July, 2015, as follows:

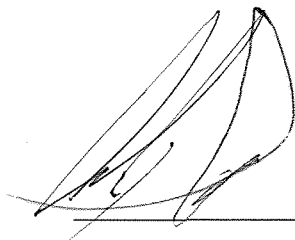
BY FACSIMILE (ONE COPY) AND UPS OVERNIGHT MAIL (ORIGINAL AND THREE COPIES)

Brent J. Fields
Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

BY ELECTRONIC MAIL AND UPS OVERNIGHT MAIL

Nancy R. Grunberg, Esq.
Gregory Kostolampros, Esq.
McKenna Long & Aldridge LLP
1900 K Street, N.W.
Washington, DC 20006
ngrunberg@mckennalong.com
gkostolampros@mckennalong.com

Stephen D. Councill, Esq.
Julia Blackburn Stone, Esq.
Rogers & Hardin, LLC
2700 International Tower
229 Peachtree Street
Atlanta, GA 30303
scouncill@rh-law.com
jstone@rh-law.com



Alexander Janghorbani
Attorney for the Division of Enforcement