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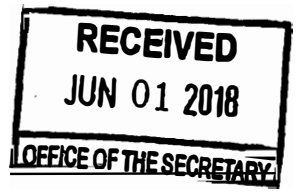

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of

LAURIE BEBO, and
JOHN BUONO, CPA,

Respondents.

THE DIVISION OF ENFORCEMENT'S BRIEF IN OPPOSITION TO RESPONDENT LAURIE BEBO'S APPEAL OF THE ADMINISTRATIVE LAW JUDGE'S ORDER RATIFYING ACTIONS

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Pursuant to the Commission's May 1 Supplemental Briefing Order, the Division of Enforcement hereby addresses pertinent matters related to the administrative law judge's ratification order. That order ratified all prior actions taken by an administrative law judge (ALJ) in this proceeding. While the Division will not restate arguments asserted in previous briefing before the Commission that addressed liability and sanctions, it will address ratification and the validity of removal protections for ALJs.

I. The Commission Properly Ratified the Agency's Prior Appointment of Its ALJs

The Commission properly "ratifie[d] the agency's prior appointment" of its ALJs in its November 30, 2017 Order. *In re: Pending Administrative Proceedings*, Securities Act Release No. 10440 (Nov. 30, 2017) ("November 30 Order"). Ratification is an age-old doctrine permitting the "adoption and affirmance by one person of an act which another, without authority, has previously assumed to do for him." 1 Floyd R. Mechem, *A Treatise on the Law of Agency* § 347 (2d ed. 1914); *Black's Law Dictionary* (10th ed. 2014) (ratification is the "[c]onfirmation and acceptance of a previous act, thereby making the act valid from the moment it was done"). The "ratification of an unauthorized act is deemed to be equivalent to a prior authority to perform it." Floyd R. Mechem, *A Treatise on the Law of Public Offices and Officers* § 545 (1890). The principal may "decide to sanction and confirm" the previously unauthorized act "and adopt it as his own," which "giv[es] force and effect to what was before unauthorized and of no effect." *A Treatise on the Law of Agency*, *supra*, § 347; *A Treatise on the Law of Public Offices and Officers*, *supra*, § 535.

There are no magic words to effectuate a valid ratification, which may be "written or unwritten, express or implied." *A Treatise on the Law of Public Offices and Officers*, *supra*, § 545; 1 *A Treatise on the Law of Agency*, *supra*, § 418. Indeed, "[t]he methods by which a ratification may be effected are as numerous and as various as the complex dealings of human

life," and "[i]t is impossible to state them all." *A Treatise on the Law of Public Offices and Officers*, *supra*, § 547.

Two factors are critical in determining whether the principal has validly ratified an agent's previously unauthorized act. First, the principal must have had the authority to perform the act when the agent undertook it and at the time of ratification. *See A Treatise on the Law of Agency*, *supra*, §§ 347, 354, 374; *FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98 (1994); *United States v. Heinszen & Co.*, 206 U.S. 370, 382 (1907); *Restatement (Third) of Agency* § 4.04(1) & cmt. b (2006). And second, the conduct of the principal must lead a third party to "reasonably . . . conclude that the act of another in [the principal's] behalf has been adopted and sanctioned" by the principal. Floyd R. Mechem, *A Treatise on the Law of Agency* § 146 (1888); *see A Treatise on the Law of Agency* (1914), *supra*, § 430 (ratification "may be inferred from the conduct of the parties").

Those two factors are satisfied here. At the time of the initial appointment and when it issued the November 30 Order, the Commission was authorized to appoint ALJs. *See* 5 U.S.C. § 3105 ("Each agency shall appoint as many administrative law judges as are necessary."); *Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010) (recognizing that Commission is a Head of Department empowered to appoint inferior officers). And just as there can be no doubt that the Commission could have made the initial appointments, it is equally clear that the Commission can, and has, "adopted and sanctioned" those actions when it "ratifie[d] the agency's prior appointment" of its ALJs in the November 30 Order.

Courts have uniformly endorsed ratification in analogous circumstances. In *Edmond v. United States*, 520 U.S. 651 (1997), petitioners sought to overturn their convictions because those convictions had been affirmed by certain military appellate judges whose original

appointments had been deemed invalid in *Ryder v. United States*, 515 U.S. 177 (1995). The Court rejected petitioners' challenge because an appropriate official had cured the constitutional error by "adopting" the judges' appointments "as judicial appointments of [his] own" before the judges issued their decisions affirming petitioners' convictions. *Edmond*, 520 U.S. at 654, 666. Other courts have likewise upheld similar ratifications following Appointments Clause and other constitutional challenges. *See, e.g.*, *CFPB v. Gordon*, 819 F.3d 1179, 1190-92 (9th Cir. 2016), *cert. denied*, 137 S. Ct. 2291 (2017); *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 115-16, 118-19 (D.C. Cir. 2015); *Doolin Sec. Sav. Bank, F.S.B. v. Office of Thrift Supervision*, 139 F.3d 203, 212-14 (D.C. Cir. 1998); *FEC v. Legi-Tech, Inc.*, 75 F.3d 704, 709 (D.C. Cir. 1996). Longstanding legal principles and judicial precedent alike thus confirm the validity of the Commission's ratification of its ALJs' appointments.

II. The ALJs' Removal Protections Do Not Violate the Constitution

Respondent Bebo has indicated that she will raise a constitutional challenge to the statutory removal protections for the Commission's ALJs. Because the comprehensive exclusive review scheme set forth in the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*, requires respondent to raise any such challenge before the Commission in the first instance, this matter will present the Commission with the opportunity to opine on this claim. But adjudicating the constitutionality of congressional enactments "has generally been thought beyond the jurisdiction of administrative agencies." *Elgin v. Dep't of the Treasury*, 132 S. Ct. 2126, 2136 (2012). Respondent will be able to raise any preserved challenge before a court of appeals if she is "aggrieved by a final order of the Commission." 15 U.S.C. § 78y(a)(1). Although a federal court will be the ultimate arbiter of any constitutional challenge, the Division writes to apprise

the Commission of arguments demonstrating that Congress's longstanding removal protections for ALJs do not violate the separation of powers.

Article II of the Constitution vests "[t]he executive Power . . . in a President of the United States of America," who must "take Care that the Laws be faithfully executed." Art. II, § 1, cl. 1; *id.*, § 3; *see also Free Enter. Fund*, 561 U.S. at 483. Unlike its specific directives governing the power of appointment, "[t]he Constitution is silent with respect to the power of removal from office, where tenure is not fixed." *In re Hennen*, 38 U.S. 230, 258 (1839). The "power of removal" has nonetheless been viewed as "incident to the power of appointment." *Id.* at 259; *see also Myers v. United States*, 272 U.S. 52, 164 (1926) (noting that the Constitution implicitly reserves to the President the "power of removing those for whom he cannot continue to be responsible").

The Supreme Court has recognized that Congress may impose limited restrictions on the removal power. For example, the Court has held that Congress may impose a for-cause removal restriction on the President's power to remove principal officers of certain independent agencies. *See Free Enter. Fund*, 561 U.S. at 493-94. And the Court has countenanced for-cause limitations on a principal officer's ability to remove inferior officers. *Id.* at 494.

In *Free Enterprise Fund*, however, the Court held that the "novel" and "rigorous" barrier to removing members of the Public Company Accounting Oversight Board by the Commission, whose members are presumed to enjoy "for cause" removal protection, left the President with insufficient ability to supervise the PCAOB's execution of the laws. 561 U.S. at 496. The Court noted that it had "previously upheld limited restrictions on the President's removal power" but only where "one level of protected tenure separated the President from an officer exercising executive power." *Id.* Two levels of "for cause" removal for an officer exercising "executive

power," the Court held, "result[s] i[n] a Board that is not accountable to the President, and a President who is not responsible for the Board." *Id.* For at least two reasons, *Free Enterprise Fund* does not compel the conclusion that Commission ALJs' "good cause" removal provided in 5 U.S.C. § 7521 violates the separation of powers.

A. Proper Construction of "Good Cause" Removal Protection

In his brief in *Raymond J. Lucia, et al. v. Securities & Exchange Commission* (S. Ct. No. 17-130) (2018 U.S. S. Ct. Briefs LEXIS 654), the Solicitor General offered an interpretation of ALJs' "good cause" removal protection that comports with constitutional constraints. Drawing from constitutional avoidance principles, the Solicitor General explained that, even where ALJs are embedded "in a structure involving more than one layer of tenure protection," a proper construction of "good cause" can alleviate constitutional concerns. Br. 51.

The statutory scheme, the Solicitor General explained, must be understood to allow "[a]gency heads [to] be able to remove ALJs who refuse to follow agency policies and procedures, who frustrate the proper administration of adjudicatory proceedings, or who demonstrate deficient job performance." Br. 47. Under this view, Section 7521 should be "interpreted to permit an agency to remove an ALJ for personal misconduct or for failure to follow lawful agency directives or to perform his duties adequately." *Id.* at 45; *see also id.* at 50. ("The term 'good cause' is thus best read to include an ALJ's failure to perform adequately or to follow agency policies, procedures, or instructions.") At the same time, an ALJ may not be removed "'at the whim or caprice of the agency or for political reasons,'" *id.* at 49 (quoting *Ramspeck v. Federal Trial Exam'rs Conference*, 345 U.S. 128, 142-43 (1953)), and "an ALJ would still be protected from removal for invidious reasons otherwise prohibited by law," *id.* at 50.

According to the Solicitor General, that interpretation of Section 7521 passes constitutional muster—and avoids the constitutional defects that rendered the provision at issue in *Free Enterprise Fund* invalid. There, "the PCAOB's members could be removed only under an 'unusually high standard' that required a 'willful' violation of the law, a 'willful' abuse of their authority, or an 'unreasonable' failure to enforce legal requirements"; here, by contrast, "[t]he intrusion on presidential authority is significantly less." Br. 51 (quoting *Free Enterprise Fund*, 561 U.S. at 503). "ALJs could accordingly be held accountable, by the Heads of Departments and the President who appoint them, for failure to execute the laws faithfully." Br. 51.[1]

B. ALJs Perform "Quasijudicial" Functions

Free Enterprise Fund is distinguishable for another reason. Crucial to the Court's decision to invalidate the dual for-cause structure for removing PCAOB members was the fact that those members exercised quintessential "executive" functions—and not solely "quasijudicial" functions. 561 U.S. at 496, 502, 505, 507 n.10. Indeed, the Court refused to extend its holding to ALJs, who "of course perform adjudicative rather than enforcement or policymaking functions, or possess purely recommendatory powers." *Id.* at 507 n.10. The

[1] The Solicitor General also stated that Section 7521(a)—which allows for removal "only for good cause established and determined by the Merit Systems Protection Board [MSPB] on the record after opportunity for hearing before the Board,"—should be construed so that "the MSPB's review is limited to determining whether factual evidence exists to support the agency's proffered good faith grounds." Br. 39; *see id.* at 52. Such an approach ensures that the Department Head retains primary control in the decision to remove an ALJ. But the Commission need not address this aspect of the statutory scheme; regardless of how the MSPB's role in the removal process is understood, agencies such as the Commission "possess the authority to reassign responsibilities away from ALJs while awaiting MSPB review of a removal decision." *Id.* at 53, 55 (citing *Mahoney v. Donovan*, 721 F.3d 633, 637 (D.C. Cir. 2013)). Consequently, "[t]hat authority avoids the possibility that an ALJ might continue to adjudicate cases beyond the point at which the Department Head has lost confidence in the ALJ's ability to exercise appropriate judgment." *Id.* at 55.

Solicitor General in *Lucia* similarly drew a line between quasijudicial duties and purely executive functions when he explained that the President, acting through principal officers, cannot remove an ALJ "to influence the outcome in a particular adjudication," and noted the need to "respect[] the independence of ALJs in adjudicating individual cases." Br. 45, 50.

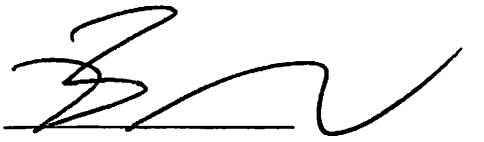
That is reflective of the Supreme Court's longstanding recognition that Congress's ability to enact limited removal protections without violating the separation of powers depends in some part on the functions of the office it has created. In *Wiener v. United States*, 357 U.S. 349 (1958), for example, the Supreme Court upheld statutory removal restrictions of War Claims Commission members because the members performed "quasijudicial" rather than purely executive functions. *Id.* at 353-54; *see also PHH Corp. v. Consumer Fin. Prot. Bureau*, 881 F.3d 75, 93 (D.C. Cir. 2018) (en banc) ("In every case reviewing a congressional decision to afford an agency ordinary for-cause protection, the Court has sustained Congress's decision, reflecting the settled role that independent agencies have historically played in our government's structure."). In *Morrison v. Olson*, 487 U.S. 654 (1988), the Court upheld good-cause restrictions on the removal of an "independent counsel," who was an executive officer with the power to investigate allegations of crime by high officers, because the restrictions provided structural independence necessary to the proper functioning of the particular office and the independent counsel had "limited jurisdiction and tenure and lack [of] policymaking or significant administrative authority." *Id.* at 689-91, 695-96.

Accordingly, because ALJs perform quasijudicial rather than purely executive functions, Congress has the latitude to impose removal restrictions to ensure the structural independence necessary to properly perform those functions—which is precisely what the Commission has

already stated in rejecting a removal challenge premised on *Free Enterprise Fund*. *See Timbervest, LLC*, Advisers Act Release No. 4197, 2015 WL 5472520, at *27 (Sept. 17, 2015).

Dated: May 31, 2018

Respectfully submitted,



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CERTIFICATE OF SERVICE

Benjamin J. Hanauer, an attorney, certifies that on May 31, 2018, he caused a true and correct copy of the foregoing *The Division of Enforcement's Brief in Opposition to Respondent Laurie Bebo's Appeal of the Administrative Law Judge's Order Ratifying Actions* to be served on the following by email:

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Dated: May 31, 2018

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