UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16293

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| In the Matter of<br><br>LAURIE BEBO, and<br>JOHN BUONO, CPA<br><br>Respondents. | RESPONDENT LAURIE BEBO'S MOTION FOR DECLARATORY AND INJUNCTIVE RELIEF FOR CONSTITUTIONAL VIOLATIONS |

## INTRODUCTION

The federal law that gives the United States Securities and Exchange Commission ("SEC" or the "Commission") its authority to arbitrarily choose the forum in which to bring enforcement actions is facially unconstitutional under the Fifth Amendment's guarantees of equal protection and due process. The proceedings instituted against Respondent Laurie Bebo pursuant to that law also violate Ms. Bebo's right to procedural due process under the Fifth Amendment because they deny her the opportunity to cross examine witnesses, among other reasons. Finally, the SEC's Administrative Law Judges ("ALJs") are protected by multiple layers of tenure in violation of Article II of the United States Constitution, and this renders the proceedings over which an SEC ALJ presides unconstitutional. Because this proceeding was instituted pursuant to an unconstitutional law, does not afford Ms. Bebo adequate process, and is overseen by an ALJ with unconstitutional tenure protection, Ms. Bebo requests that this Court declare unconstitutional and immediately enjoin this proceeding.[1]

[1] On January 3, 2015, Ms. Bebo filed a Complaint in the Federal District Court for the Eastern District of Wisconsin asserting claims based on these constitutional violations. On the same day, Ms. Bebo filed a motion for a preliminary injunction to stop the progress of the unconstitutional administrative proceeding instituted against her by the Division of Enforcement. On March 3, 2015, after briefing on the preliminary injunction motion was completed, the district court issued an order stating that although Ms. Bebo's constitutional claims are "compelling and

## FACTUAL BACKGROUND

The SEC has been given unfettered discretion under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank"), to bring enforcement actions against unregulated persons seeking the same remedies—including punitive civil monetary penalties—in either internal administrative proceedings or in federal district court. The SEC chooses which forum would be most beneficial to the government, without regard to the rights of the respondents. In this case, the SEC has chosen a forum that allows it to investigate, prosecute, adjudicate and, if successful in supporting its charges before an administrative law judge, provide appellate review of a case for which the very same Commissioners approved the filing of charges in the first place. There are no statutes or regulations to guide these decisions, and the statutory regime is fundamentally unconstitutional.

On December 3, 2014, after spending more than two years investigating, instead of filing an action in federal district court against Ms. Bebo, the Commission issued an Order Instituting Public Administrative and Cease-and-Desist Proceedings ("OIP"), initiating these expedited administrative proceedings against Ms. Bebo. During its two year investigation into whether there had been any violations of the federal securities laws in relation to certain periodic financial reports filed with the Commission by Assisted Living Concepts, Inc. ("ALC"), the Division of Enforcement issued 43 subpoenas for testimony or documents, collected millions of pages of documents (over 300 gigabytes of data), and took a cumulative total of 55 days of on-the-record testimony. Those financial reports, filed on Forms 10-K (annual reports) and 10-Q (quarterly reports) consist of thousands of pages of information about ALC.

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meritorious," it lacked subject matter jurisdiction to hear Ms. Bebo's case. The district court dismissed Ms. Bebo's action, stating that the proper forum for adjudication of her constitutional claims is this Court. On March 10, 2015, Ms. Bebo noticed her appeal to the United States Court of Appeals for the Seventh Circuit. Her appellate brief is due on April 20, 2015, the same day the hearing in this proceeding is scheduled to begin.

The net result of this extensive investigation is the allegation that a single statement—asserting compliance with a lease agreement—out of those thousands of pages of financial statements and disclosure documents was false or misleading because it failed to provide additional information about *how* the Company was meeting the lease requirements. The Division alleges, in turn, that Ms. Bebo, who was the Chief Executive Officer of ALC during the time period in which the challenged periodic reports were filed with the Commission (approximately 2009 to 2012), should be found guilty of committing securities fraud; should be subject to a cease-and-desist order (the functional equivalent of an injunction); should be subject to civil monetary penalties of hundreds of thousands, or even millions, of dollars; and should be subject to a permanent ban on serving as an officer or director of a publicly-traded company.

Prior to the passage of Dodd-Frank, which became effective July 21, 2010, the SEC would have been required by law to bring charges seeking these remedies in federal district court, in particular if the SEC determined it wanted to punish Ms. Bebo by inflicting civil monetary penalties. However, pursuant to Section 929P(a) of Dodd-Frank, the SEC may now obtain the same remedies in administrative proceedings overseen by the Commission itself. Providing an agency with the ability to obtain the same remedy in federal court or in an administrative proceeding is a unique (and unconstitutional) enforcement regime previously unheard of in the large and ever-growing administrative state.

And because the remedies are the same in either forum, in bringing these charges administratively, the SEC presumably concluded that the government would have been disadvantaged by Ms. Bebo's anticipated assertion of her Seventh Amendment right to a jury trial in district court. Under established Supreme Court precedent, this statutory regime, which

penalizes the exercise or anticipated exercise of a fundamental constitutional right, is a violation of the Ms. Bebo's right to due process.

Similarly, because Section 929P(a) provides the SEC with arbitrary and unlimited discretion to choose which citizen will be subject to which forum, Dodd-Frank on its face establishes a process that violates Ms. Bebo's right to equal protection under the law. Dodd-Frank established a structure where the government may choose the forum based solely on whether it would be in the government's interest to deprive a citizen of her right to a jury trial and other substantive and procedural protections afforded by the Federal Rules of Civil Procedure and Federal Rules of Evidence. Thus, in Ms. Bebo's case, the SEC concluded that it would be advantageous as a litigation tactic to deprive Ms. Bebo of her right to have a jury determine the validity of its charges. It determined that it would be advantageous to deprive Ms. Bebo of her right to have a trial subject to the Federal Rules of Evidence, which preclude unreliable evidence like hearsay. It determined that it would be advantageous to deprive Ms. Bebo of the numerous substantive and procedural mechanisms of the Federal Rules of Civil Procedure, including depositions and other discovery.

And it determined it would be advantageous to deprive Ms. Bebo of the time necessary to prepare her defense to the charges against her because the Commission's rules presume a final hearing (trial) in the matter should occur within four months of issuing the OIP. Given the time constraints, Ms. Bebo's defense will necessarily be prejudiced in light of the need to review and digest the massive investigative file, including the millions of documents that the Division has collected over the course of its two-year investigation, retain and prepare experts, and do all the other necessary things that go into defending complex litigation with a fact pattern extending

over four years. This is particularly unfair given the Division has had over two years to prepare its case.

In similar cases, the SEC will exercise the unbridled discretion granted to it by Dodd-Frank to bring cases in federal district court, where the citizen will be afforded all of the rights to which Ms. Bebo has been denied. In those cases, the SEC will have concluded that the defendant will be unsympathetic to a jury, or the SEC needs the procedural mechanisms afforded by the Federal Rules, or the SEC needs time to identify and procure expert witnesses. A statutory regime that permits such arbitrary determination constitutes a blatant violation of the Constitution's guarantee of equal protection under the laws.

As is clear from the above discussion, the two reasons the SEC sought and obtained the additional authority under Dodd-Frank, and why it has recently begun to bring more cases internally, is both expediency and to increase its rate of "conviction." As recent articles have illustrated, the SEC is significantly more successful in its home court—where every verdict during the twelve months ending September 2014 was in favor of the SEC—contrasted with its record in federal district court.[2]

## ARGUMENT

The remedy for a litigant injured by a facially unconstitutional statute "is necessarily directed at the statute itself and must be injunctive and declaratory." *Ezell v. City of Chi.*, 651 F.3d 684, 698 (7th Cir. 2011). A successful "facial attack means the statute is wholly invalid and cannot be applied to anyone." *Id.* Because Section 929(P)(a) of Dodd Frank is unconstitutional on its face and as applied to Ms. Bebo, the proceeding instituted pursuant to it cannot go on.

[2] *See* Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, Wall Street Journal (Oct. 21, 2014), *available at* http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590. The article states the SEC "is increasingly steering cases to hearings in front of the agency's appointed administrative judges, who found in its favor in every verdict for the 12 months through September, rather than taking them to federal court." In district court verdicts, the SEC won only 61% of the time in cases proceeding to a verdict.

## I. THE FEDERAL LAW ENABLING THIS PROCEEDING, SECTION 929P(A) OF DODD-FRANK, IS UNCONSTITUTIONAL ON ITS FACE.

For the first fifty years of the SEC's existence, it had no authority to obtain monetary penalties at all, much less from ordinary citizens that were not regulated members of the securities industry. Rather, the SEC was limited to seeking injunctions of on-going fraud or disgorgement in federal court. *See* Carole B. Silver, *Penalizing Insider Trading: A Critical Assessment Of The Insider Trading Sanctions Act of 1984*, 1985 Duke L.J. 960, 960-63, 966 (describing state of remedies available to the government, and noting SEC first obtained authority to obtain civil penalties in federal court in 1984). In addition, the SEC could bar securities professionals (or their firms), like broker-dealers and investment advisors, from the industry in administrative proceedings. *Id.* at 966 n.43. But if a citizen was forced to pay a fine as a result of violating the federal securities laws, Congress required the Department of Justice to bring those claims in federal court. *See id.* at 960-63. Of course, the citizen would have all of the Constitutional protections provided to a citizen being prosecuted by her government, including the requirement that the government prove guilt beyond a reasonable doubt. *Id.*

In 1984, Congress first granted the SEC authority to obtain civil penalties in federal district court, but it was limited to insider trading cases and the penalty was limited to three times the amount of profit gained or losses avoided as a result of the insider trading. *Id.* (citing *Insider Trading Sanctions Act of 1984*, Pub. L. No. 98-376, 98 Stat. 1264 (1984)). The SEC continued to have no authority to assert civil penalties in administrative proceedings against even regulated entities and persons.

Six years later, in the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Congress granted the SEC authority to obtain civil monetary penalties in administrative proceedings only against regulated entities and persons like brokers and investment advisors.

Pub. L. No. 101-429, 104 Stat. 931, §§ 202, 301 (1990). In addition, Congress broadened the SEC's authority to obtain civil penalties in federal district court against citizens otherwise unregulated by the Commission. *Id.* §§ 201, 302.

For the next twenty years, the remedies the SEC could obtain against an ordinary citizen were much like the enforcement authority of other federal agencies, where Congress has provided for additional, more severe and punitive remedies outside of the administrative proceeding context where the citizen being prosecuted would have the various procedural protections afforded to an ordinary citizen in either a civil or criminal case being brought against her by the government.[3] Thus, like other federal agencies with enforcement powers, the level of due process afforded the citizen tracked the punitive gradient of the remedy sought. This legal regime set a delicate balance—a balance that in various decisions from the Supreme Court evaluating similar agency adjudication frameworks was held constitutionally permissible. *See, e.g. Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442 (1977) (holding no Seventh Amendment jury trial right in OSHA administrative proceeding).[4]

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[3] For example, under the Clean Water Act ("CWA"), the Environmental Protection Agency ("EPA") can enforce its orders through administrative actions or judicial actions. With respect to administrative actions, § 309(g) of the CWA, 33 U.S.C. § 1319(g), prescribes two classes of penalties that the EPA can levy against violators. Based on a finding that a person has violated a permit condition, the EPA Administrator may assess either a Class I or Class II civil penalty. *See* 33 U.S.C. § 1319(g). Class I penalties, for less egregious conduct, may not exceed $16,000 per violation, with a maximum of $37,500. Violations that are more serious invite Class II penalties, which may not exceed $16,000 for each day the violation continues, with a maximum of $187,500. *Id.* (The EPA adjusts the penalties as necessary for inflation according to a formula prescribed by the Debt Collection Improvement Act of 1996.) Section 309(d) of the CWA also authorizes the EPA to bring federal judicial enforcement actions seeking civil penalties. A court can assess a civil penalty not to exceed $37,500 per day for each violation. Unlike for administrative actions, the CWA does not identify any total maximum penalty amount for the court. *See* 33 U.S.C. § 1319(d). Further, under the FTC Act, the Federal Trade Commission ("FTC") can enforce requirements of consumer protection law through either administrative or judicial processes. *See* 15 U.S.C. §§ 45(b), 53(b). In administrative proceedings, the FTC cannot levy civil penalties for unfair or deceptive acts or practices; however, if the FTC files suit in federal court, the court can award monetary equitable relief (including restitution or rescission of contract), among other relief, against violators. *Id.*

[4] The Occupational Health and Safety Administration does not have the option to try to impose civil penalties in federal court. Indeed, it has no authority to bring cases in federal court, except to restrain "any conditions or practices in any place of employment which are such that a danger exists which could reasonably be expected to cause death or serious physical harm immediately or before the imminence of such danger can be eliminated through the enforcement procedures...." 29 U.S.C. § 662.

Section 929P(a) of Dodd-Frank destroyed that delicate balance when it granted the SEC authority to obtain civil penalties against any citizen in the country in an administrative proceeding.[5] In granting the SEC this authority, the remedies that the SEC can seek administratively are now functionally identical to the remedies that it can obtain in federal district court. In fact, the legislative history regarding Section 929P(a) of Dodd-Frank confirms that this was Congress' intent:

> *Section 211. Authority to impose civil penalties in cease and desist proceedings*
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> This section streamlines the SEC's existing enforcement authorities by permitting the SEC to seek civil money penalties in cease-and-desist proceedings under Federal securities laws. The section provides appropriate due process protections by making the SEC's authority in administrative penalty proceedings coextensive with its authority to seek penalties in Federal court. As is the case when a Federal district court imposes a civil penalty in a SEC action, administrative civil money penalties would be subject to review by a Federal appeals court.

H. Rep. No. 111-687, at 78 (2010) (Investor Protection Act of 2009) (emphasis added).

By granting this parity of remedy, Congress threw off the delicate due process balance that the Supreme Court had approved and in a manner not permitted by the Constitution. The fundamental Constitutional deficiency of the structure is that it places in the hands of the government prosecutor, in the form of the SEC, the sole power to provide or withhold the citizen's Seventh Amendment right to a jury trial for the same conduct and remedies. More problematic, the government will only grant the citizen her Constitutional right to a jury trial

[5] The SEC's enforcement director acknowledged that the remedies available in either forum are on par: "Ceresney responded to the view by some that the SEC will bring more cases administratively to avoid losses in court. He noted that the SEC won eight out of its last 10 court cases. Congress gave the SEC the authority to obtain the same remedies as in federal court, he explained, and administrative proceedings offer a streamlined procedure in which cases can be brought much more quickly, while the evidence is still fresh." *Officials discuss administrative proceedings and more at PLI conference*, Federal Securities Law Reports, Nov. 20, 2014, at 2 (emphasis added). Although there are minor, immaterial differences in the remedies that can be achieved in federal court or district court, as set forth in the Enforcement Director's comments, the remedies are functionally equivalent.

when the Commission, in consultation with the Division of Enforcement attorneys that conducted the investigation, concludes that, on balance, it is to the government's advantage to permit the citizen her right to a jury. Indeed, in a recent speech, the only factors that the SEC's enforcement director identified with respect to how the Commission, in consultation with Division of Enforcement attorneys bringing the case, will decide to file in district court is whether it would be advantageous as a litigation tactic to file there. *See* Andrew Ceresney, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#.VJ25mV4AA.

As set forth in more detail below, the legal scheme established by Congress through Section 929P(a) of the Act impermissibly allows SEC prosecutors the unguided discretion[6] to choose whether a respondent will have a right to be tried by a jury. Such a law violates the equal protection and due process guarantees of the Fifth Amendment, and is therefore facially unconstitutional.

### A. Section 929P(a) of Dodd-Frank violates the Fifth Amendment's guarantee of equal protection, and is therefore unconstitutional on its face.

The Constitution's promise of equal protection guarantees that similarly situated individuals will be similarly treated. Laws that create classifications that "affect some groups of citizens differently than others" implicate the concerns of equal protection and are struck down

[6] The SEC's decision to bring its enforcement actions in one forum as opposed to the other is not guided by any reasoned direction from Congress or even the Commission itself. *See* Commissioner Michael S. Piwowar, Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly, and Efficient SEC (Feb. 20, 2015), *available at* http://www.sec.gov/news/speech/022015-spchcmsp.html#.VR8HHvnF9Fs ("Our enforcement program could also benefit from a look through the lens of fairness. In order to ensure that the Commission does not engage in arbitrary or capricious conduct in enforcement matters, the Commission should formulate and adhere to a consistent set of guidelines when conducting our enforcement proceedings. ... To avoid the perception that the Commission is taking its tougher cases to its in-house judges, and to ensure that all are treated fairly and equally, the Commission should set out and implement guidelines for determining which cases are brought in administrative proceedings and which in federal courts.").

unless they can survive judicial scrutiny. *McGowan v. Maryland*, 366 U.S. 420, 425 (1961); *see also Pers. Adm'r of Mass. v. Feeney*, 442 U.S. 256, 279 (1979). This constitutional safeguard is offended if the government's classification rests on grounds irrelevant to the achievement of a legitimate government objective. *McGowan*, 366 U.S. at 425.[7]

A statutory scheme that, for no legitimate purpose, affords some litigants a jury trial while denying the same to similarly situated litigants violates the equal protection guarantee of the Fifth Amendment. The Supreme Court's consideration in *Baxstrom v. Herold* of such a statutory scheme is instructive. 383 U.S. 107 (1966). The petitioner in *Baxstrom*, a prison inmate in New York at the end of his sentence, challenged the New York statutory scheme that allowed for inmates at the end of their sentences to be committed to a mental hospital without the jury review available to all other persons civilly committed in that state. *Id.* at 110. Under New York law at that time, "[a]ll persons civilly committed . . . other than those committed at the expiration of a penal term, [were] expressly granted the right to de novo review by jury trial of the question of their sanity . . . ." *Id.* at 111.

Applying rational basis scrutiny, the Court found "no conceivable basis for distinguishing the commitment of a person who is nearing the end of a penal term from all other civil commitments." *Id.* at 111-12. Where the question to be determined by the tribunal was the same—whether the person before it was mentally ill—the Equal Protection Clause required that all people facing that determination be given the same protections. *Id.* The Court explained that "the State, having made this substantial review proceeding generally available on this issue, may

[7] While the Fifth Amendment does not contain the words "equal protection" as does the Fourteenth Amendment, which applies only to the states, the United States Supreme Court has interpreted the Due Process Clause of the Fifth Amendment to include an equal protection guarantee enforceable against the federal government. The Court's approach to Fifth Amendment equal protection claims "has always been precisely the same as to equal protection claims under the Fourteenth Amendment." *Weinberger v. Wiesenfeld*, 420 U.S. 636, 638 n.2 (1975).

not, consistent with the Equal Protection Clause of the Fourteenth Amendment, arbitrarily withhold it from some." *Id.* at 111.

Almost a decade later the Supreme Court again considered the equal protection implications of a state's commitment laws, this time in Wisconsin. *Humphrey v. Cady,* 405 U.S. 504 (1972). Though the Court remanded before finding a constitutional violation, the Court noted in strong language the constitutional problem with denying a jury to one class of commitment candidates but not another when the determination to be made (mental illness warranting institutionalization) and the potential outcome (commitment) was the same for both classes.

The petitioner in *Humphrey* challenged on equal protection grounds the constitutionality of Wisconsin's disparate treatment of people committed for treatment under the state's Mental Health Act and its Sex Crimes Act. *Id.* at 508. A person committed under Wisconsin's Mental Health Act at that time had a statutory right to have a jury determine whether he met the standards for commitment, but a person facing commitment under Wisconsin's Sex Crimes Act, like the petitioner, was not afforded a jury determination. *Id.*

Before remanding for an evidentiary hearing, the Court observed that under its reading of the two Acts, the *same conduct* could warrant commitment proceedings under either Act. If it developed on remand that the "petitioner was deprived of a jury determination, or of other procedural protections, merely by the arbitrary decision of the State to seek his commitment under one statute rather than the other," the Court stated, "[t]he equal protection claim would seem to be especially persuasive . . . ." *Id.* at 512.

Thus, *Baxstrom* and *Humphrey* stand for the proposition that when the alleged wrongful conduct and the remedy sought are the *same*, a statutory scheme that allows the government

arbitrarily to choose its forum (and thereby choose whether the defendant will receive a jury trial) violates the Constitution's promise of equal protection. Such is the case with Section 929P(a) of Dodd-Frank, which grants the SEC authority to obtain civil penalties against any citizen in the country in either district court, where the defendant can elect to be tried before a jury, or an administrative proceeding, where she cannot.

Moreover, with its passage of Section 929P(a), Congress provided no guidance to SEC prosecutors as to when and for what reasons it would be appropriate for them to choose to bring their charges in an administrative proceeding rather than in district court. And the SEC's exercise of that authority is no different than the grant of arbitrary and unbridled discretion to withhold the right to a jury or other procedural protections found constitutionally infirm in *Baxstrom* and *Humphrey*. If the "arbitrary decision of the State to seek . . . commitment under one statute rather than the other" was viewed with such judicial ire in *Humphrey*, so must be the SEC's authority arbitrarily to select its forum, one with a jury and one without. *Id.*

Here, the government's unequal treatment under Section 929P(a) of unregulated people accused of securities violations is *at best* arbitrary. Recent statements made by the SEC's enforcement director demonstrate that the unequal treatment of defendants under this scheme is actually a litigation tactic put in place to give the government its best opportunity to win. *See* Ceresney, *supra*. Even under the least stringent form of constitutional scrutiny, a discriminatory law that has an *illegitimate* purpose must be struck down.

### B. Section 929P(a) of Dodd-Frank violates the Fifth Amendment's guarantee of due process, and is therefore unconstitutional on its face.

Where the principal objective of a statutory scheme or government practice is "to discourage the assertion of constitutional rights it is patently unconstitutional." *Chaffin v. Stynchcombe*, 412 U.S. 17, 33 n.20 (1973). And "[t]o punish a person because he has done what

the law plainly allows him to do is a due process violation of the most basic sort...." *Bordenkircher v. Hayes*, 434 U.S. 357, 363 (1978). Courts have invalidated statutory provisions that penalize citizens for possessing or exercising their constitutional rights.

The Supreme Court's decision in *United States v. Jackson*, 390 U.S. 570 (1968) is instructive. There, the Court held that the capital punishment provision of the federal anti-kidnapping law was unconstitutional because it penalized a defendant for exercising his right to a jury trial. The problem with the statutory regime in *Jackson* was that the defendant would be exposed to a death sentence if he exercised his right to have a jury determine the outcome of his case. *Id.* at 570-71. By waiving his right to have a jury determine his guilt, and instead agreeing to have his case heard by a federal judge, the maximum sentence he could receive, if found guilty by the judge, would be life in prison. *Id.*

In striking down the penalty provision, the Court stated "Whatever might be said of Congress' objectives, they cannot be pursued by means that needlessly chill the exercise of basic constitutional rights." *Id.* at 582. And the Court held that "Congress cannot impose ... a penalty in a manner that needlessly penalizes the assertion of a constitutional right." *Id.* at 583.

Relying on *Jackson*, the court in *Wymelenberg v. Syman*, 328 F. Supp. 1353 (E.D. Wis. 1971), struck down a Wisconsin statute that forced new residents coming into the state to wait two years before they could obtain a divorce. The court stated "the instant statute must clearly fail as it is impermissible for a state to attempt to chill an individual's constitutional right to travel to and settle in the state of his choice." *Id.* at 1355.

Similarly, the Supreme Court has also found violations of due process where the government retaliates against the exercise of constitutional rights. For example, in *Blackledge v. Perry*, 417 U.S. 21 (1974), the Supreme Court found unconstitutional the prosecutorial discretion

authorized by a state statutory regime because of the risk that the prosecutor's actions would be motivated by the goal of penalizing a defendant's assertion of his right to a jury trial. There, North Carolina charged Perry with a misdemeanor assault. *Id.* at 22. State law provided that such misdemeanors could be tried initially in a court without a jury, and then appealed at the option of the defendant for a trial before a jury *de novo*. *Id.* However, North Carolina law also permitted the prosecutor to obtain a new felony indictment for the same conduct, which the prosecutor did after Perry exercised his right to have a jury determine his original misdemeanor charge. *Id.* at 23.

The Court held that risk of punishment for the exercise of Perry's right to appeal and have a jury determine the charges against him violated due process. *Id.* at 28-29. The Court reasoned that no actual evidence of bad faith or foul motive need be established because the statute itself permitted the potential for an improper motive to enter the government's decision-making.[8] *Id.*; *see also Marshall v. Jerrico, Inc.*, 446 U. S. 238, 249 (1980) (citations omitted) ("In appropriate circumstances the Court has made clear that traditions of prosecutorial discretion do not immunize from judicial scrutiny cases in which the enforcement decisions of an administrator were motivated by improper factors or were otherwise contrary to law.").

This same reasoning provides the foundation for the Supreme Court's jurisprudence with respect to the Fifth Amendment right against self-incrimination. *See Griffin v. California*, 380 U.S. 609 (1965); *Miranda v. Arizona*, 384 U.S. 436 (1966). Thus, in *Griffin* the Court held that a defendant could not be penalized by the prosecution impeaching the defendant at trial with his pre-trial custodial silence. In reaching this conclusion, the Court reasoned that the Constitution

[8] Notably, the Court recognized the government's interest in streamlining prosecutions and conserving resources as potentially driving the decision to retaliate against persons that exercised their right to have a new *de novo* trial in front of a jury and impermissibly injecting "the opportunities for vindictiveness" into the decisions. *Perry*, 417 U.S. at 27-28. Expediency, of course, is the same factor that creates the opportunity for vindictiveness in the SEC's selection of forum under Dodd-Frank.

cannot condone "a penalty imposed by courts for exercising a constitutional privilege." *Griffin*, 380 U.S. at 614. Citing *Griffin*, the *Miranda* Court explained that "it is impermissible to penalize an individual for exercising his Fifth Amendment privilege when he is under police custodial interrogation." 384 U.S. at 468 n.37.

In this case, Congress has gone beyond simply imposing a penalty on a person for asserting her constitutional right. Rather, the Act affects a wholesale transfer of Ms. Bebo's constitutional right to a jury trial *to the government itself.* Because the remedies that the SEC may obtain in either forum are functionally equivalent, the sole consideration for the government in exercising its discretion of where to bring the case is where it is more likely to be successful. Consequently, the government can and will conclude after Dodd-Frank that there are circumstances where the defendant would be unsympathetic to a jury. In those cases, the government will penalize the citizen and bring the case in federal court. In other instances, such as in this case, the government may conclude that a jury may view the defendant as sympathetic or credible, and thus determine that the defendant should be stripped of her right to a jury and forced to proceed administratively. Either way, the government is penalizing the citizen for possessing the Seventh Amendment jury right in way that is inimical to the Constitution.

Dodd-Frank, on its face, also permits the SEC to file a case in district court and wait to see if the defendant asserts her right to a jury trial. The SEC has the option to then voluntarily dismiss the case and obtain the same remedy administratively. It is beyond cavil that such a practice, which is permissible under Dodd-Frank, runs afoul of the dictates of *Jackson*, *Perry*, and their progeny. It makes no difference, from a constitutional perspective, that Dodd-Frank sets up a mechanism whereby the Commission, in confidential consultations with its staff attorneys that will prosecute the case, assumes that a citizen will assert her jury trial right if the

case is filed in district court and then concludes that the benefit to the government of proceeding in that forum does not outweigh the perceived "cost" of the citizen's right to a jury trial (and other procedures that govern district court actions). Just because the government's actions are a preemptive punishment of the citizen's exercise of her constitutional rights makes it no less penal and no less a constitutional violation. *See United States v. Alvarado-Sandoval*, 557 F.2d 645, 645-46 (9th Cir. 1977).

## II. THE SEC'S ADMINISTRATIVE PROCEEDING IS UNCONSTITUTIONAL AS APPLIED TO MS. BEBO BECAUSE IT DEPRIVES HER OF PROCEDURAL DUE PROCESS.

"Procedural due process imposes constraints on governmental decisions which deprive individuals of 'liberty' or 'property' interests within the meaning of the Due Process Clause of the Fifth or Fourteenth Amendments." *Mathews v. Eldridge*, 424 U.S. 319, 332 (1976). In determining whether governmental action has violated procedural due process, courts first consider whether plaintiffs will be deprived of a liberty or property interest, and then must determine "what process is due." *Cooper*, 196 F.3d at 813.

In this case, it is indisputable that Ms. Bebo has a property interest at stake in the administrative proceeding. *See Cooper*, 196 F.3d at 814 (finding property right in a discrimination claim being evaluated by a governmental body); *Wisconsin v. Constantineau*, 400 U.S. at 437 (recognizing a property interest in "a person's good name, reputation, honor, or integrity"); *Goldberg v. Kelly*, 397 U.S. 254, 264 (1970) (loss of a person's livelihood); *Collins Sec. Corp. v. SEC*, 562 F.2d 820, 825 (D.C. Cir. 1977), *overruled on other grounds by Steadman v. SEC*, 450 U.S. 91 (1981) (stating "[Commission] proceedings do often culminate, as here, with the imposition of severe sanctions on those found to have violated the statute").

Consequently, the question becomes what procedural mechanisms are required in order for the administrative proceeding to satisfy due process. In determining whether the limited

procedures afforded to Ms. Bebo in the administrative proceeding initiated against her by the Commission, the Supreme Court has established a three-factor balancing test as set forth in *Mathews v. Eldridge*. *See* 424 U.S. at 335. The first factor involves an assessment of "the private interest that will be affected" by the action of the government. *Id.* at 334. The second factor involves evaluating "the risk of an erroneous deprivation of such interest through the procedures used" in the administrative proceeding and "the probable value, if any, of the additional or substitute procedural safeguards." The third factor involves a review of the "Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." *Id.* at 335; *see also Cooper*, 196 F.3d at 814. As set forth below, these factors weigh heavily in favor of Ms. Bebo under the circumstances of this case.

**A. The private interest involved is significant.**

As Supreme Court Justices Powell and Stewart recognized in their dissent in *Steadman v. SEC*, a finding of fraud by the SEC along with the "harsh penalties" that may be imposed, such as industry employment bars, result in "serious stigma and deprivation." 450 U.S. at 106; *see also Collins*, 562 F.2d at 825-26. And the Supreme Court recognized the significant private interest at stake in administrative proceedings that adjudicate issues that could also constitute criminal law violations, finding a potential for substantial injury in an administrative proceeding resulting from "the personal and economic consequences alleged to flow from" an adverse finding that the respondent violated the law. *Jenkins v. McKeithen*, 395 U.S. 411, 424 (1969).

Ms. Bebo is facing allegations that she defrauded investors. Based on the allegations of the OIP, which are wholly without merit, the SEC intends to seek a fraud finding and a potential permanent bar from her acting as an officer or director of a public company. In addition, Ms.

Bebo faces the potential imposition of substantial civil penalties. Consequently, the private interest at stake in the administrative proceeding is significant.

**B. The risk of an erroneous deprivation of Ms. Bebo's property interest is high because, among other things, she will be unable to call or cross-examine critical witnesses.**

It is axiomatic that "[t]he right to present evidence is, of course, essential to the fair hearing required by the Due Process Clause." *Jenkins*, 395 U.S. at 429. Related to the right to present evidence, due process generally requires that a citizen who is the subject of an administrative adjudication of the sort presented by this case have the right to confront or cross-examine witnesses. *Id.*; *see also Goldberg v. Kelly*, 397 U.S. 254, 269 (1970) ("In almost every setting where important decisions turn on questions of fact, due process requires an opportunity to confront and cross-examine adverse witnesses."); *Texas-Capital Contractors, Inc. v. Abdnor*, 933 F.2d 261, 269 (5th Cir. 1990) ("Although evidentiary procedures are somewhat relaxed in administrative proceedings, cross-examination of witnesses is basic to due process of law.").

In *Jenkins*, the Court struck down a state statute governing administrative proceedings before the Louisiana Labor-Management Commission of Inquiry (the "Commission"). The Commission possessed statutory authority to investigate and make factual findings with respect to whether companies or individuals violated certain criminal laws in the field of labor-management relations. *Id.* at 414. The findings were in the nature of a probable cause determination that would be passed along to other authorities for potential prosecution, and also had the collateral effect of branding the person subject to its decisions as a criminal. *Id.* at 416-17. In the proceedings, the targets of the investigation had severe limits on the ability to cross-examine or confront other witnesses. *Id.* at 428-29. The respondents in the administrative proceedings also had severely limited ability to present evidence on their own behalf. *Id.* at 429.

Indeed, the Supreme Court was troubled by the fact that "[t]he right to present oral testimony from other witnesses and the power to compel attendance of those witnesses may be denied in the discretion of the Commission." *Id.* "We do not mean to say that the Commission may not impose reasonable restrictions on the number of witnesses and on the substance of their testimony; we only hold that a person's right to present his case *should not be left to the unfettered discretion of the Commission.*" *Id.* (emphasis added).

Similarly, in cases involving a claimant's rights to social security benefits, courts have consistently found that it would be a deprivation of due process to prevent a claimant from being able to subpoena witnesses to the hearing on critical issues in the case. *See Lonzollo v. Weinberger*, 534 F.2d 712 (7th Cir. 1976); *Gullo v. Califano*, 609 F.2d 649 (2d Cir. 1979); *Treadwell v. Schweiker*, 698 F.2d 137 (2d Cir. 1983); *Lidy v. Sullivan*, 911 F.2d 1075 (5th Cir. 1990). For example, in *Lonzollo*, a claimant was denied social security disability benefits in an administrative proceeding. In the proceeding, the administrative law judge relied on a report of a treating physician in denying disability benefits. The judge also denied the claimant the ability to subpoena and cross-examine the treating physician. The Seventh Circuit held that this violated the claimant's right to procedural due process because "the claimant has a right to subpoena the physician and cross-examine him concerning the report." 534 F.2d at 714.

The *Treadwell* case also involved an administrative proceeding regarding Treadwell's claim to social security disability benefits, although the issue there was whether Treadwell could prove that she worked long enough to secure a benefit under the program. Thus, in the administrative proceeding, Treadwell requested that subpoenas be issued in the administrative proceeding to the claimant's former employers for testimony at the hearing. 698 F.2d at 138. The administrative law judge precluded Treadwell from subpoenaing her former employers for

testimony at the hearing and also refused to enforce certain document subpoenas that he did allow to issue. The witnesses and evidence were critical in establishing the Treadwell's work history, the key issue in the case.

The court of appeals held that the claimant's inability to compel testimony from witnesses about critical issues in the case violated Treadwell's right to procedural due process. The court reasoned: "The question whether Treadwell had been employed [by the subpoenaed party] was crucial to her claim. Further, her ability to challenge [other evidence] depended upon issuance of the subpoena. Treadwell was clearly unable to present evidence rebutting [other witnesses'] assertions." *Id.* at 143. Consequently, the proceeding lacked fundamental fairness and denied Treadwell of her right to procedural due process. *Id.* at 143-44.

In this case, the SEC's decision to bring charges against Ms. Bebo in an administrative proceeding will impair her ability to present critical evidence in her defense of the charges—evidence that could be available and adduced if the action had been brought in district court instead. Importantly, the deprivation of her ability to obtain and submit this evidence cannot be cured by any procedural mechanism in the administrative proceeding.

In the OIP, the SEC alleges that Ms. Bebo made or caused ALC to make false or misleading statements about the Company's compliance with a lease for eight of its assisted living facilities. In addition, in order to prove a claim for fraud under Section 10(b) of the Securities Exchange Act, the SEC must prove that Ms. Bebo acted with scienter. Scienter, or intent to deceive investors, is the critical inquiry in most securities fraud cases. Among other defenses, Ms. Bebo will demonstrate that evidence of scienter is lacking because she disclosed the employee leasing practice that is at the heart of the SEC's allegations to ALC's Board of Directors and its audit committee that oversaw the company's investor disclosures. Disclosure of

the alleged fraudulent conduct to the company's Board of Directors (among other personnel inside and outside of the company) is obviously inconsistent with intent to deceive the company's investors.

Yet, due to the fact that the SEC has brought the charges against Ms. Bebo in an administrative proceeding, she will be unable to secure the presence of key members of the company's Board of Directors for hearing or obtain any discovery from those witnesses as part of the proceedings. This is because they are Canadian citizens who may not be subpoenaed as part of the administrative proceeding. Specifically, the Securities Exchange Act only authorizes the "attendance of witnesses and the production of any such records.... *from any place in the United States* or any State ...." *See* 15 U.S.C. 78u(b) (emphasis added). In other words, an ALJ's subpoena power is restricted to U.S. territorial boundaries. *Id.*; *see also* 17 C.F.R. § 201.232. Further, even if an ALJ issued an order to serve a subpoena on a third party outside U.S. borders, federal courts would not have the power to enforce the subpoena. *See, e.g.*, *Commodity Futures Trading Comm'n v. Nahas*, 738 F.2d 487, 491, 496 (D.C. Cir. 1984).

A summary of the witnesses from whom Ms. Bebo will be unable to elicit any testimony or discovery are described in the following chart:

| Witness | Role at ALC |
|---|---|
| David Hennigar | Chairman of the board and principal of entity owning controlling voting interest in ALC. |
| Mel Rhinelander | Vice Chairman of the board and Ms. Bebo's liaison to the board and mentor. |
| Malen Ng | Chairwoman of the audit committee of the Board of Directors. |
| Alan Bell | Member of the audit committee. |
| Derek Buntain | Member of the audit committee. |

Indeed, the OIP is replete with allegations regarding what Ms. Bebo did or did not report to members of the Board of Directors:

| OIP Paragraph | Allegation |
|---|---|
| 12 | Board interested in expanding operations by acquiring right to operate the facilities. |
| 16 | Certain directors [including Bell and Buntain] were allegedly opposed to entering the lease. |
| 19 | ALC's Board required Ms. Bebo to report on compliance with the covenants, and alleging by inference that she failed to report that ALC was meeting the covenants through the employee leasing practice. |
| 21 | Board raised concerns in August 2008 about ALC's ability to meet certain covenants in the lease. |
| 24 | "Rather than report the defaults to Ventas, ALC's board of directors, or ALC's shareholders, Bebo directed Buono and his staff to include employees and other non-residents in the financial covenant calculations." |
| 40 | Bebo tried to convince ALC's board not to disclose the employee leasing practice to potential bidders interested in acquiring ALC. |
| 52 | Bebo allegedly tried to convince ALC's board to not disclose the employee leasing practice to Ventas in April 2012, and actively lobbied against Mr. Bell's demand that ALC include specific reference in a settlement proposal to Ventas. |

Here, the SEC chose to deny Ms. Bebo the procedural and other protections contained in the Federal Rules of Civil Procedure applicable in federal district court, where she would have been able to obtain deposition and document discovery from each of these witnesses. Canada is not a signatory to the Hague Convention, so parties use letters rogatory—a formal written request from one court to another for assistance—to compel Canadian witnesses to produce documents and be examined under oath. After receiving a request from a U.S. court, Canadian courts have broad discretion under the *Canada Evidence Act*, R.S.C. 1985, c. E-5, pt. II (and equivalent provincial legislation) to enforce letters rogatory and generally do so unless the request is determined to be contrary to public policy. *See Gulf Oil Corp. v. Gulf Can. Ltd.*, (1980) 2 S.C.R. 39, 57 (Can.) (noting that it is a "rare occasion, certainly in relations with the

United States" where letters rogatory are determined to run counter to Canadian public policy, and thus are not enforced). The resulting evidence can then be used in the court proceedings.

### C. There is no significant governmental interest in depriving Ms. Bebo of the right to call witnesses in her defense.

This governmental interest factor is based on an assessment of the fiscal or administrative burdens that the additional or substitute procedural requirement would entail. *Matthews*, 424 U.S. at 335. Here, requiring the SEC to re-file its claims in federal court would constitute a minimal burden, given that for the first seventy-five years of its existence that is the forum where claims such as this one would have been brought. *See Cooper*, 196 F.3d at 814 (affirming district court preliminary injunction that required government to return to procedural mechanism in place prior to statutory amendment).

Indeed, the government has no significant interest in depriving Ms. Bebo of her ability to call witnesses and obtain evidence in her defense.[9] As the Supreme Court stated at around the time the SEC was created:

> The v[a]st expansion of this field of administrative regulation in response to the pressure of social needs is made possible under our system by adherence to the basic principles that the Legislature shall appropriately determine the standards of administrative action and that in administrative proceedings of a quasi-judicial character the liberty and property of the citizen shall be protected by the rudimentary requirements of fair play.

*Morgan v. United States*, 304 U.S. 1, 14-15 (1938). Ms. Bebo, through her requested injunction, simply requests that the rudimentary requirements of fair play be imposed.

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[9] In apparent recognition of the due process problems presented by the unavailability of key foreign-based witnesses in an administrative proceeding, the SEC recently dismissed an administrative proceeding for this reason. *See In re Jordan Peixoto*, Admin. Proc. Rulings Release No. 2133 (Dec. 15, 2014), *available at* http://www.sec.gov/alj/aljorders/2014/ap-2133.pdf ; Ed Beeson, *SEC Hits Limits In Collapsed Herbalife Insider Case*, Law360 (Dec. 19, 2014), http://www.law360.com/articles/606128/sec-hits-limits-in-collapsed-herbalife-insider-case.

## III. THE SEC'S CHOSEN FORUM VIOLATES ARTICLE II OF THE UNITED STATES CONSTITUTION.

An administrative proceeding is an internal SEC hearing, initiated by the Commission after an investigation and recommendation of charges by the SEC's own attorneys, litigated by those same attorneys, governed by the SEC's Rules of Practice ("Rules of Practice," or "RoP"), and conducted by a Commission-appointed Administrative Law Judge ("SEC ALJ"). That is, administrative proceedings do not afford respondents the opportunity to have their case heard by a jury. Instead, an SEC ALJ presides over the proceedings, acting as the factfinder and deciding matters of law. But because Commission ALJs enjoy multiple layers of protection from removal in violation of Article II, the SEC's administrative proceedings are unconstitutional, including the proceedings initiated against Ms. Bebo.

Article II of the U.S. 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[.]" U.S. Const. art. II, § 1, cl. 1; *id.* § 3. "In light of '[t]he impossibility that one man should be able to perform all the great business of the State,' the Constitution provides for executive officers to 'assist the supreme Magistrate in discharging the duties of his trust.'" *Free Enterprise*, 561 U.S. at 483 (quoting 30 Writings of George Washington 334 (J. Fitzpatrick ed. 1939)). Nonetheless, under *Free Enterprise*, pursuant to Article II's vesting of the executive power in the President, executive officers—such as the SEC ALJs—cannot be separated from the President by multiple levels of protection from removal. *Id.* at 484. "The President cannot 'take Care that the laws be faithfully executed' if he cannot oversee the faithfulness of the officers who execute them." *Id.* (citation omitted). That is, Article II is violated when an executive officer can only be removed for good cause, and the power to remove that officer is held by another officer who can only be removed for good cause. *See id.* SEC ALJs enjoy at least two levels of good-cause protection,

with the result being ALJs who are "not accountable to the President, and a President who is not responsible for the" ALJs. *Id.* at 495. "[S]uch multilevel protection from removal is contrary to Article II's vesting of the executive power in the president." *Id.* at 484. As such, the SEC administrative proceedings governed by SEC ALJs violate Article II and are unconstitutional.

**A. SEC ALJs are appointed by the Commission—with their duties, salary, and means of appointment and removal specified by statute—and are protected by multiple layers of tenure.**

To start, the SEC is a "Department" of the Executive Branch. *Free Enterprise*, 561 U.S. at 511 ("Because the Commission is a freestanding component of the Executive Branch, not subordinate to or contained within any other such component, it constitutes a 'Departmen[t]' for the purposes of the Appointments Clause."). The Commissioners are the "heads" of the Department, *Free Enterprise*, 561 U.S. at 512-13, and the Commissioners appoint the SEC ALJs. The SEC ALJ's position, duties, salary, and means of appointment for and removal from office are specified by statutes and regulations.

Under the Administrative Procedures Act ("APA"), 5 U.S.C. § 500 et seq., "[e]ach agency shall appoint as many administrative law judges as are necessary...." 5 U.S.C. § 3105. The APA—5 U.S.C. §§ 556, 557—sets forth the ALJs' considerable power and authority, as have also been delegated by the Commission and incorporated into the securities laws, regulations, and the SEC's RoP. *See, e.g.,* 15 U.S.C. §7 8d-l (the SEC "shall have the authority to delegate ... any of its functions to ... an individual Commissioner, an administrative law judge, or an employee ..."); 17 C.F.R. § 200.14 ("...the Office of Administrative Law Judges conducts hearings in proceedings instituted by the Commission."); 17 C.F.R. § 200.30-9. Indeed, the SEC's rules and regulations specifically do not limit the powers provided by the APA. *See* 17 C.F.R. § 201.111 ("No provision of these Rules of Practice shall be construed to limit the powers of the hearing officer provided by the [APA], 5 U.S.C. § 556, 557.") An ALJ

receives a career appointment, not subject to probationary period requirements. 5 C.F.R. § 930.204. In addition, the SEC ALJs' salaries are set by statute, and are based on the Executive Schedule. 5 U.S.C. § 5372; *see also* 5 U.S.C. § 5311.

SEC ALJs are also protected by multiple layers of tenure. That is, SEC ALJs are protected from removal except for "good cause" as determined by the Merit Systems Protection Board ("MSPB"). 5 U.S.C. § 7521(a). Similarly, the SEC Commissioners, who have the power to remove the ALJs, cannot be removed by the President from their position except for "inefficiency, neglect of duty, or malfeasance in office." *See Free Enterprise*, 561 U.S. at 487, 495 (citations omitted) ("none of [the Commissioners] is subject to the President's direct control"); *MFS Sec. Corp. v. SEC*, 380 F.3d 611, 619-20 (2d Cir. 2004) ("the power to remove Commissioners belongs to the President, and even that is 'commonly understood' to be limited to removal for 'inefficiency, neglect of duty or malfeasance in office.'") (citations omitted). Further, members of the MSPB can "be removed by the President only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d).

**B. ALJs are officers as contemplated by Article II.**

This multi-level protection is significant because SEC ALJs are "officers" of the Executive Branch by virtue of, among other things, the statutory authority creating their position; their career appointments by heads of an Executive Branch department; the statutory and regulatory requirements proscribing their duties, appointment, and salary; the significant authority and discretion they exercise, as noted above and detailed below; and their power, in certain cases, to issue the final decision of the SEC, all as noted above and described below.

Indeed, Justice Scalia has observed: "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." *Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868, 910 (1991) (Scalia, J., concurring) (emphasis omitted).

The Supreme Court has already concluded that special trial judges in Tax Court are "inferior officers" for purposes of Article II. *See Freytag*, 501 U.S. at 881. Like these special trial judges, SEC ALJs are "inferior officers." *See id.* Rejecting the Commissioner's argument that, because under certain circumstances special trial judges lack authority to enter a final decision, they may be deemed "employees," the Supreme Court focused on the significant discretion they exercise in concluding that they are not merely "employees":

> [T]his 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 court of carrying out these important functions, the special trial judges exercise significant discretion.

*Freytag*, 501 U.S. at 881-82. The Supreme Court noted that both courts addressing the issue "considered the degree of authority exercised by the special trial judges to be so 'significant' that it was inconsistent with the classifications of 'lesser functionaries' or employees[,]" and agreed. *Freytag*, 501 U.S. at 881. Further,

Here, too, the SEC ALJs exercise significant authority and discretion (they "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders[,]" among other things). *See id.* at 881-82. And as detailed above, the office of the SEC ALJs is "established by law," with the ALJs' "duties, salary, and means of appointment for office ... specified by statute." *See id.* at 881.

**a. SEC ALJs exercise considerable discretion and significant authority.**

SEC ALJs exercise considerable discretion and significant authority in these administrative proceedings, which makes them officers as contemplated by Article II of the U.S. Constitution.

As noted above, the SEC ALJs' authority is delegated to them by the Commission. *See* 15 U.S.C. 78d-1(a) (the SEC "shall have the authority to delegate ... any of its functions to ...an individual Commissioner, an administrative law judge, or an employee ..."); 17 C.F.R. § 200.14(a) ("...the Office of Administrative Law Judges conducts hearings in proceedings instituted by the Commission."); 17 C.F.R. § 200.30-9 (the Commission "hereby delegates ... to each [ALJ] the authority ... [t]o make an initial decision ..."). The SEC ALJs, also referred to as "hearing officers," are given significant authority by regulation:

> The [ALJs] are responsible for the fair and orderly conduct of the proceedings and have the authority to:
> (1) Administer oaths and affirmations;
> (2) Issue subpoenas;
> (3) Rule on offers of proof;
> (4) Examine witnesses;
> (5) Regulate the course of a hearing;
> (6) Hold pre-hearing conferences;
> (7) Rule upon motions; and
> (8) ... prepare an initial decision containing the conclusions as to the factual and legal issues presented, and issue an appropriate order.

17 C.F.R. § 200.14(a); *see also* 17 C.F.R. § 201.111 (ALJs have power to, inter alia, revoke, quash or modify subpoenas; receive relevant evidence and rule upon admission of evidence; consider and rule upon all procedural and other motions; regulate the conduct of the parties and their counsel; reopen any hearing prior to the filing of an initial decision, etc.).

Under the SEC Rules of Practice an SEC ALJ is given the power to perform the following, among other things: amend the SEC's OIP (RoP 200(d)(2)), and require amended answers to be filed (RoP 220(b)); require the SEC to file a more definite statement of specified

matters of fact or law to be considered or determined (RoP 220(d)); grant or deny leave to amend an answer (RoP 220(e)); grant or deny leave to move for summary disposition, if necessary, and rule on motions for summary disposition (*see* RoP 250(a), (b)); stay proceedings pending Commission consideration of offers of settlement (RoP 161(c)(2)); express views on offers of settlement (RoP 240(c)(2)); grant extensions of time (RoP 161); find a party in default and set aside a default (RoP 155); reject filings that do not comply with the SEC's Rules of Practice (RoP 180(b)); enter default, 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 (RoP 180(c)); order that scandalous or impertinent matter be stricken from any brief or pleading (RoP 152(f)); order production of documents pursuant to subpoena (RoP 230(a)(2), 232); order depositions, and act as the "deposition officer" (RoP 233, 234); regulate the SEC's use of investigatory subpoenas after the institution of proceedings (RoP 230(g)); modify the Rules of Practice with regard to the SEC's document production obligations (RoP 230(a)(1)); require the SEC to produce documents it has withheld (RoP 230(c)); issue protective orders governing confidentiality of documents (RoP 322); certify issues for interlocutory review, and decide whether to stay proceedings after an application for or grant of review (RoP 400(c), (d)); direct the parties to meet for prehearing conferences, and preside over such conferences as the ALJ "deems appropriate." (RoP 221(b)); order any party to furnish prehearing submissions (RoP 222(a)); allow the use of prior sworn statements when, in its discretion, it would be desirable, in the interests of justice, to do so, and limit or expand the parties' intended use of the same (RoP 235(a), (a)(5)); take "official notice" of facts not appearing in the evidence in the record (RoP 323); determine the scope of cross-examination (RoP 326); order that hearings not be recorded or transcribed (RoP 302(a)); issue orders specifying corrections to the transcript (RoP 302(c)); rule

on motions to correct errors in the initial decision (RoP 111(h)); impose sanctions on parties for contemptuous conduct (RoP 180(a)); disqualify himself or herself from considering a matter (RoP 112(a)); consolidate proceedings (RoP 201(a)); regulate appearance of amici (RoP 210(d)); modify the rule regarding the participation of intervening parties and amici, among others (RoP 210(f)).

**b. SEC ALJs have the power to issue the final decision of the Commission under certain circumstances.**

After the hearing, the SEC ALJ issues an "initial decision," which includes: "findings and conclusions, and the reasons or basis therefore, as to all the material issues of fact, law or discretion presented on the record and the appropriate order, sanction, relief, or denial thereof." RoP 360(b); *see also* 17 C.F.R. 200.14(a). The ALJ's initial decision becomes the final decision of the Commission if no timely petition is filed, and the Commission does not review the decision on its own initiative. *See* RoP 360. With certain exceptions inapplicable here, the Commission's decision to review is discretionary. In determining whether to grant review, the Commission considers whether "a prejudicial error was committed in the conduct of the proceeding; or ... 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." RoP 411(b)(2).

If the Commission does not review the matter (either by petition or on its own accord), the decision becomes final, and "the action of [the] administrative law judge . . . shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 15 U.S.C. § 78d-l(c). The Commission issues an order, and "[t]he decision becomes final upon

issuance of the order[, which] shall state the date on which sanctions, if any, take effect." RoP 360(d)(2).[10]

In sum, because SEC ALJs cannot be removed except for "good cause," the Commissioners are similarly protected from removal but for "inefficiency, neglect of duty, or malfeasance in office," and the MSPB members (who determine whether good cause exists to remove an ALJ) are also protected from removal but for "inefficiency, neglect of duty, or malfeasance in office," SEC ALJs are "officers" protected by multiple layers of protection from removal in violation Article II. Under this multilevel protection scheme:

> [T]he 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.'

*Free Enterprise*, 561 U.S. at 484 (quoting *Morrison v. Olson*, 487 U.S. 654, 693 (1988)). Because the President cannot oversee SEC ALJs in accordance with Article II, SEC administrative proceedings are governed by SEC ALJs in violation of the Constitution.

## CONCLUSION

For the foregoing reasons, Ms. Bebo respectfully requests that the Court declare unconstitutional and immediately enjoin this proceeding.

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[10] In *Landry v. Federal Deposit Insurance Corp.*, 204 F.3d 1125 (D.C. Cir. 2000), the Unites States Court of Appeals for the District of Columbia Circuit held that FDIC ALJs were not inferior officers. *See id.* at 1133-34. Attempting to distinguish *Freytag*, the court noted that, unlike the special trial judges in Tax Court, "the [FDIC] ALJs ... can never render the decision of the FDIC. Final decisions are issued only by the FDIC Board of Directors." *Id.* at 1133 (citation omitted). Notwithstanding the disputed premise that the *Freytag* decision turned upon the special trial judges' ability to render a final decision under certain circumstances, the facts in *Landry* are distinguishable from those here. That is, unlike FDIC ALJs, SEC ALJs can issue final decisions under certain circumstances.

Dated this 3rd day of April, 2015.

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