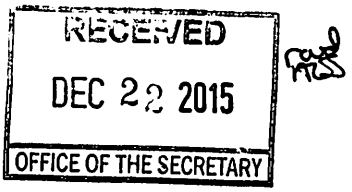
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16353

In the Matter of	)
Spring Hill Capital Markets, LLC, Spring Hill Capital Partners, LLC, Spring Hill Capital Holdings, LLC, And Kevin D. White,	)
Respondents.	)

RESPONDENTS' PETITION FOR REVIEW

Respondents, Spring Hill Capital Markets, LLC ("SHCM"), Spring Hill Capital Partners, LLC ("SHCP"), Spring Hill Capital Holdings, LLC ("SHCH") and Kevin White ("White") (collectively the "Respondents") submit their petition for review of an initial decision by Administrative Law Judge Carol Fox Foelak dated November 30, 2015 ("Initial Decision") pursuant to the Commission's Rule of Practice 410(b).

I. Introduction

Judge Foelak correctly found that White sought to comply with the registration requirements in establishing SHCP and that White's conduct did not warrant a suspension of any length. Indeed, Judge Foelak found that White's partner, John Fernando, "evaluated" the agreement between Rafferty and SHCP and that Rafferty drafted the agreement. Despite her findings as to White's good faith in establishing SHCP--and lack of any involvement in evaluating and drafting the agreement between SHCP and Rafferty--Judge Foelak, nevertheless,

ordered White to disgorge $3,953,609 in gross trading revenue that was generated pursuant to the arrangement between Rafferty and SHCP.

Judge Foelak ordered White to disgorge the $3.9 million dollars without any finding whatsoever that White actually received any of the trading revenue and without the Commission introducing any evidence that he did. Moreover, Judge Foelak did not deduct from her disgorgement order undeniably legitimate payments from Rafferty to its registered representatives who were also employees of SHCP or legitimate business expenses of SHCP. As a result, Judge Foelak's disgorgement order as to White is no more than an impermissible penalty. It certainly does not represent, as the case law requires, the return of "ill-gotten gains" that White received.

Also, Judge Foelak's order should be reversed as SHCP did not violate section 15(a) and, even if it did, the 15 (a) claim is time barred and--in all events--the entire procceding against the Respondents is unconstitutional as the appointment of Judge Carol Fox Foelak violated the Appointments Clause of the United States Constitution. Moreover, despite every single fact witness testifying that Rafferty, not SHCM, purchased the Gramercy Bond, Judge Foelak found (unbelievably) that SHCM actually purchased it and, therefore, caused a net capital violation at SHCM, that it did not report to the SEC, and a books and records violation for failing to record the purchase.

Consequently, Judge Foclak's Initial Decision, as it relates to the 15(a) claim against SHCP, White and SHCH and the resultant $3.9 million dollar disgorgement order in connection with that claim and the net capital and books and records claim against SHCM, must be reversed.

II. Argument

A. The 15(a) violation is time barred.

Judge Foelak held that "cease-and-desist orders and disgorgement are not subject to the five year statute of limitations provided in 28 U.S.C. §2462." Initial Decision at 4. In so holding, Judge Foelak declined to follow the well-reasoned, federal court, decision in *SEC v. Graham,* 21 F. Supp. 3d 1300 (S.D. FL 2014)(5 year statute of limitations imposed by §2462 applies to SEC actions seeking disgorgement). *Graham* followed the United States Supreme Court's decision in *Gabelli v SEC*, 133 S.Ct 1216, (2013) wherein the United States Supreme Court unanimously held that an SEC enforcement claim accrues five years from the occurrence of the event that gives rise to the SEC's charge. *Id.* at 1220-1121.

28 U.S.C. §2462 imposes a five year statute of limitation on certain "actions, suits, or proceeding[s]" by the government of the United States including SEC enforcement actions. 28 U.S.C. §2462 states:

> Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

As such, the Supreme Court held that SEC enforcement actions seeking civil penalties for claims that accrued more than five years before the date of commencement are barred by the five year statute of limitations imposed by 28 U.S.C. §2462. *Id.*

In *Gabelli*, the Supreme Court explained that statutes of limitations are important because they "set a fixed date when exposure to the specified government enforcement efforts ends, advancing the basic policies of all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities." *Id.* at 1221 (internal quotation marks omitted). Moreover, the United States Supreme Court stated succinctly the inherent fairness of statutes of limitations as follows:

> statutes of limitations are intended to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared. They provide security and stability to human affairs. We have deemed them vital to the welfare of society, and concluded that even wrongdoers are entitled to assume that their sins may be forgotten.

Id. (internal quotation marks and citations omitted).

As such, Judge Foelak erred as a matter of law in failing to hold that the SEC's 15 (a) claim is time barred.

B. SHCP did not violate Section 15(a).

Judge Foelak found that "White sought to comply with the registration provisions through the arrangement with Rafferty, whereby certain SHCP employees became registered representatives associated with Rafferty and Rafferty acted as introducing firm for transactions negotiated by these SHCP employees." Initial Decision at 15. Judge Foelak also found that the SHCP employees, who became registered representatives of Rafferty, commenced their trading only "after they were registered with Rafferty" and "[t]here were no trades done by SHCP personnel prior to their becoming associated with Rafferty as registered representatives." Initial Decision at 7, footnote 10. Nevertheless, Judge Foelak held, incorrectly, that "SHCP willfully violated the Exchange Act Section 15(a)." Initial Decision at 12.

SHCP attempted, in good faith, to establish a legitimate and well-established business relationship with Rafferty. A relationship that Rafferty--a registered broker-dealer since 1989--was advocating. As early as the 1970s, the concept of an "independent contractor" of a broker-dealer evolved to allow the independent contractor to be affiliated with the registered broker-dealer for the purposes of offering securities for sale. *See* Alexander C. Dill, "Broker-Dealer Regulation Under the Securities Exchange Act of 1934: The Case of Independent Contracting," 1994 Columbia Bus. L. Rev. 189, 196 (1994).

Indeed, these independent contractor arrangements have grown commonplace in the industry: as of 2013, approximately 64% of all registered representatives of broker dealers operated as independent contractors. *See* Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission, from David Bellaire, Esq., Executive Vice President, Financial Services Institute, at 2 (July 5, 2013), available at: http://www.scc.gov/comments/4-606/4606-3138.pdf . Securities regulatory agencies have formally recognized the concept of certain natural persons associating with a registered broker-dealer as independent contractors since at least 1982. *See* Letter to Gordon S. Macklin, President, NASD, from Douglas Scarff, Director, Division of Market Regulation, the Commission [1982-83 Transfer Binder], Fed. Sec. L. Rep. (CCH) 77,303, at 78,116 (June 12, 1982). In the structure of the SHCP/Rafferty relationship, the only likely misstep was SHCP's receipt of compensation that derived from the securities transactions that Rafferty effectuated. Simply receiving compensation that is derived from securities transactions, however, is not conclusive of broker activity. *See SEC v. Kramer*, 778 F.Supp.2d 1320, 1338-1341 (M.D. Fla. 2011).

As such, SHCP did not violate section 15 (a).

C. Kevin White and SHCH, did not aid and abet SHCP's 15(a) violation[1].

For White to be held liable for aiding and abetting SHCP's 15(a) violation, the Commission must prove "(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) 'knowledge' of this violation on the part of the aider and abettor; and (3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation." *SEC v. DiBella,* 587 F.3d 553 566 (2d Cir. 2009*) quoting Bloor v. Carro, Spanbock, Londin, Rodman & Fass,* 754 F.2d 57, 62 (2d Cir.1985). "[T]he three requirements cannot be considered in isolation from one another." *Id. quoting IIT v. Cornfeld,* 619 F.2d 909, 922 (2d Cir. 1980). Substantial assistance requires a showing that the alleged "aider and abettor" associated themselves with the venture, participated in something that they wished to bring about, and that by their actions sought to make it succeed. *SEC v. Apuzzo,* 689 F.3d 204, 212 (2d Cir. 2012) quoting *United States v. Peoni,* 100 F.2d 401, 402 (2d Cir.1938).

For "causing" liability, three elements must also be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation." Robert M. Fuller, Exchange Act Release No. 48406, 2003 SEC LEXIS 2041, at *13-14 (Aug.25, 2003), pet. for review denied, 95 F.App'x 361 (D.C.Cir.2004).

As stated above, Judge Foelak specifically found that "White sought to comply with the registration provisions through the arrangement with Rafferty, whereby certain SHCP employees became registered representatives associated with Rafferty and Rafferty acted as introducing firm for transactions negotiated by these SHCP employees." Initial Decision at 15. Moreover,

[1] The arguments related to Mr. White apply equally to SHCH because Mr. White is the majority owner of SHCH. See Stipulations Entered into By the Parties dated May 6, 2015, at 3.

Judge Foelak found that "Rafferty drafted the agreement regarding this arrangement; it was evaluated on Spring Hill's side by John Fernando, a SHCP partner." Initial Decision at 7. Despite finding that (1) White sought to comply with the registration requirements, (2) Rafferty drafted the agreement and (3) John Fernando (not White), from SHCP, evaluated the deal on behalf of SHCP, Judge Foelak held, nevertheless, that "White and SHCH willfully aided and abetted and caused SHCP's violation." Initial Decision at 12.

The Initial Decision is devoid of any factual findings whatsoever to support that White aided, abetted or caused SHCP's 15(a) violation. To the contrary, the Initial Decision is replete with evidence that White sought to comply with securities laws through SHCP's arrangement with Rafferty and that Rafferty and John Fernando set-up the arrangement between SHCP and Rafferty.

The broker-dealer registration requirement "facilitates both discipline over those who may engage in the securities business and oversight by which necessary standards may be established with respect to training, experience, and records." *Reg's Properties, Inc. v. Fin & Real Estate Consulting Co.*, 678 F.2d 552, 561 (5th Cir.1982); *Eastside Church of Christ v. Nat'l Plan, Inc.*, 391 F.2d 357, 362 (5thCir.1968). Every SHCP employee that executed the trades were registered representatives of Rafferty and, as such, were subject to FINRA and SEC oversight to ensure "discipline over those who may engage in the securities business and oversight by which necessary standards may be established with respect to training, experience, and records." *Reg's Properties, Inc.*, 678 F.2d at 561. As such, White and SHCH did not aid, abet or cause SHCP's 15(a) violation.

D. SHCM had no trades and, therefore, could not have a net capital violation, an inaccurate trade blotter or an obligation to notify the SEC of an alleged net capital violation related to the Second Gramercy Trade.

Every witness that testified about the Gramercy Trade, from both Rafferty and SHCM, testified that the Gramercy Trade was a Rafferty trade and impacted Rafferty's net capital. Martens, from Rafferty, testified that every trade that Paul Tedeschi made was a Rafferty trade. Tr.Tes. p. 1176, l. 8-16. Every trade that Paul Tedeschi made, or any other SHCP employee as a registered representative of Rafferty, was figured into Rafferty's net capital calculation from April of 2009 through the end of 2010. Tr.Tes. p. 1176, l. 17-24. Rafferty's net capital was calculated in connection with the Gramercy Trade. Tr.Tes. p. 769, l. 16-20. Rafferty's trade blotter shows that Rafferty purchased the Gramercy Bond in connection with the Gramercy Trade. Div. Ex. 181. Tedeschi testified that he bought the bond on behalf of Rafferty as a registered representative of Rafferty. Tr.Tes. p. 852, l. 17-21. Patrick Quinn, the FINOP at SHCM, testified that Mr. Tedeschi executed the Gramercy Trade on behalf of Rafferty and that any impact on net capital would have been Rafferty's net capital. P. 933, lines 2-13.

Indeed Rafferty already stipulated to the Gramercy Trade as a Rafferty trade. Rafferty stipulated to the books and records violation for the Gramercy Trade in its settlement with the Commission. See OIP related to Rafferty dated May 15, 2014 at 14 and 15. Thus, Rafferty admitted that the Gramercy Trade was a Rafferty trade (and was inaccurately listed on its trade blotter), not a SHCM's trade. As such, the Commission is judicially estopped from asserting now that the trade was a SHCM's trade and should have been kept accurately on SHCM's books and records.

Judge Foelak completely ignored all of the overwhelming evidence that Rafferty, and not SHCM, purchased the Gramercy Bond. SHCM cannot be held liable for a net capital violation for a bond it did not buy, an inaccurate trade blotter for a trade it did not make or a failure to notify the SEC about a non-existent net capital violation. Even the Commission's expert, Chan, had to acknowledge that if SHCM did not purchase the Gramercy bond, then SHCM did not violate net capital rules. Tr.Tes. p. 994, l. 8-12. As such, SHCM did not have a net capital violation, an inaccurate trade blotter and was not obligated to notify the SEC of a net capital violation.

E. The Administrative Process is unconstitutional as the ALJ's appointments violate the Appointments Clause of Art. II of the United States Constitution.

Judge Foelak, in one-sentence and without citing to a single federal court decision, rejected the Respondents' well-founded argument that the administrative process is unconstitutional because the appointment of administrative law judges violates the Appointments Clause of Article II of the United States Constitution. Initial Decision at 3. In rejecting the Respondents' constitutional argument, out of hand, Judge Foelak ignored recent federal court precedent on the Appointments Clause issue. Namely, Judge Foelak ignored the Decision and Order issued by Honorable Richard M. Berman, United States District Court, Southern District of New York, *Duka v. Securities and Exchange Commission,* 1:15-CV-00358 dated August 3, 2015. In *Duka*, Judge Berman denied the SEC's motion to dismiss the plaintiff's appointment clause challenge. *Id.* at 2. The *Duka* decision supports Respondents' argument that the SEC ALJ's are inferior officers and their hiring violates the Appointment Clause. Specifically, Judge Berman held that "SEC ALJ's are 'inferior officers' because they exercise significant authority pursuant to the laws of the United States." *Id.* at 3 (citing *Freytag v. Commissioner,* 501 U.S.

868, 881 (1991)). Further, in his decision, Judge Berman noted that "[t]here appears to be no dispute that the ALJ's at issue in this case are **not** appointed by the SEC Commissioners." (emphasis in original) *Id.* at 5. Judge Berman's comment is consistent with the SEC's concession in *Tilton v. Securities and Exchange Commission,* that Judge Carol Foelak was not appointed by the Commission. *See* Respondents' Opening Brief at 28-29.

Subsequently on August 12, 2015, Judge Berman issued a "Decision and Order Granting Preliminary Injunction." In his August 12, 2015 Order, Judge Berman reiterated his holding that SEC ALJ's are "inferior officers" and the manner in which they are appointed likely violates the Appointments Clause as they are not appointed by the SEC Commissioners. *See* p. 2-4.

Moreover, Judge Foelak ignored the Order issued by Honorable Judge Leigh Martin May, United States District Court, Northern District of Georgia, *Gray Financial, Inc. v. Securities and Exchange Commission,* 1:15-CV-0492-LMM dated August 4, 2015. In *Gray Financial,* Judge May granted the Plaintiff's request for a preliminary injunction. In reaching her conclusion, Judge May found that SEC ALJ's are "inferior officers." *Id.* 26-35. Specifically, Judge May stated , "[t]he Court finds the SEC' arguments unavailing; the SEC ALJ's are inferior officers." *Id.* at 35. Further, Judge May held that the manner in which SEC ALJ's are appointed likely violates the Appointments Clause because they are not appointed by the "President, a department head, or the Judiciary." *Id.* at 36.

Likewise, Judge Foelak ignored the Order issued by Honorable Judge Leigh Martin May, United States District Court, Northern District of Georgia, *Timbervest, LLC. v. Securities and Exchange Commission,* 1:15-CV-2106-LMM dated August 4, 2015. In *Timbervest*, Judge May reached the same conclusion as *Gray Financial* that (1) SEC ALJ's are inferior officers; and (2) the manner in which they are appointed likely violates the Appointments Clause. *Id.* at 17-27.

The Appointments Clause provides as follows:

> [The President] shall nominate, and, by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

U.S. Const., art. II, sec. 2, cl. 2 (emphasis added).

In *Free Enterprise*, the Supreme Court ruled that for purposes of the Appointments Clause, the Commission is a "Department" of the United States, and that the Commissioners collectively function as the "Head" of the Department with authority to appoint "inferior Officers." 561 U.S. at 511-13. The Commission's use of SEC ALJs violates the Appointments Clause. It bears emphasis that these defects are specific to SEC ALJs. For example, Immigration Court administrative judges are appointed by the Attorney General (the "Head" of the Department of Justice, for Article II purposes), as required by the Appointments Clause. *See* 8 C.F.R. § 1003.10.

It also bears emphasis that in other cases challenging the status of SEC ALJs under Article II, the SEC has never claimed the Commissioners appoint ALJs. Rather, the Commission has argued only that SEC ALJs are mere employees rather than "inferior Officers" subject to Art. II appointment and tenure protection rules. *SEC v. Duka*, No. 15 Civ. 00357 (Doc. 13), at 11-12 (Jan. 28, 2015). In fact, on May 11, 2015, the SEC has conceded during the hearing on the application for a preliminary injunction in *Tilton v. SEC* that SEC ALJ Foelak was not appointed by the Commissioners. *See* Goloboy Declaration at Exhibit 4 at pp. 25:22—26:3 ("[W]e acknowledge that the commissioners were not the ones who appointed, in this case Judge Foelk [sic]"). Thus, the decisive constitutional question in this case is whether SEC ALJs are "inferior

Officers" under Article II. As described below, Spring Hill is likely to succeed on this decisive question.[2] Further, at the *Tilton* preliminary injunction hearing in *Tilton* the SEC conceded, "We acknowledge, that, your Honor, if this Court were to find ALJ Foelk [sic] to be an inferior officer, that that would make it more likely that the plaintiffs can succeed on the merits of the Article II challenge, at least with respect to the appointments clause challenge." *Id.* at 29:10-17.

1. The Broad Powers Exercised by SEC ALJs

In determining whether administrative officers qualify as "inferior Officers" subject to the restrictions imposed by Article II, courts have repeatedly quoted the general rule formulated by the Supreme Court in *Buckley v. Valeo*: that "[a]ny appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States' . . . ." 424 U.S. 1, 126 (1976).

The Commission's own description of the role played by its ALJs in administrative proceedings easily satisfies this test, illustrating the broad range and scope of responsibilities of an SEC ALJ:

> Administrative Law Judges are independent judicial officers who in most cases conduct hearings and rule on allegations of securities law violations initiated by the Commission's Division of Enforcement. They conduct public hearings at locations throughout the United States in a manner similar to non-jury trials in the federal district courts. Among other actions, they issue subpoenas, conduct prehearing conferences, issue defaults, and rule on motions and the admissibility of evidence. At the conclusion of the public hearing, the parties submit proposed findings of fact and conclusions of law. The Administrative Law Judge prepares an Initial Decision that includes factual findings, legal conclusions, and, where appropriate, orders relief.
>
> The Commission may seek a variety of sanctions through the administrative proceeding process. An Administrative Law Judge may order

[2] Judge Rudolph Randa of the Eastern District of Wisconsin dismissed a complaint raising an Article II challenge (among other constitutional challenges) for lack of jurisdiction, despite "find[ing] that [Plaintiff]'s claims are compelling and meritorious." *Bebo v. SEC*, No. 15-C-3, 2015 WL 905349, at *2 (E.D. Wis. Mar. 3, 2015).

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

See S.E.C., Office of Administrative Law Judges, About the Office, *available at* www.sec.gov/alj (emphasis added).

2. SEC ALJs are Indistinguishable from Other Judges Who Are Deemed "Officers"

The SEC ALJs at issue in this case are indistinguishable from Officers described by the Supreme Court in *Freytag* when it determined that the special trial judges appointed by the Tax Court in that case qualified as inferior Officers. First, the Supreme Court in *Freytag* found that "the office of special trial judge is established by law. . . ." 501 U.S. at 881 (quotation marks and citations omitted). The position of an SEC ALJ is similarly established by law. *See* 5 U.S.C. § 556; 15 U.S.C. § 78d-1.[3] Next, *Freytag* found that "the duties, salary, and means of appointment for [special trial judges] are specified by statute. 501 U.S. at 881 (citations omitted). Again, the same is true for SEC ALJs. *See* 5 U.S.C. §§ 556(c), 557 (setting forth responsibilities and powers of administrative law judges under the Administrative Procedure Act); 5 U.S.C. §§ 5311, 5372 (governing the salaries available to administrative law judges); 5 U.S.C. § 3105 (governing the appointment of administrative law judges by federal agencies).

[3] Further, in addition to the factors identified in *Freytag*, Section 21 of the Securities Act of 1933 strictly limited who may preside at an SEC hearing, "All hearings shall be public and may be held before the Commission *or an officer of officers* of the Commission designated by it..." 15 U.S.C. §77u (emphasis added). In sum, since 1933, Congress and the Commission have used the word "officer" to denote who must preside at an SEC hearing in the absence of the Commissioners. This is because the SEC ALJ's perform a function otherwise reserved exclusively for the Commissioners.

Regarding the responsibilities performed by special trial judges, the Supreme Court found that they were authorized to take sworn testimony. 501 U.S. at 881. SEC ALJs can also take testimony. *See* 5 U.S.C. §§ 556(c)(1), (4). The Supreme Court found that the special trial judges could conduct trials. 501 U.S. at 881-82. The same is true of SEC ALJs, *see* 17 CFR § 201.111, and the Commission itself compares the hearings conducted by its ALJs to "non-jury trials in the federal district courts." *See supra* at 15. The Court in *Freytag* found that special trial judges were authorized to rule on the admissibility of evidence, 501 U.S. at 881-82, as are SEC ALJs. 17 CFR § 201.320. Finally, the Supreme Court found that special trial judges had "the power to enforce compliance with discovery orders." 501 U.S. at 881-82. Similarly, SEC ALJs have the authority to oversee discovery efforts, 17 CFR § 201.230; to issue, quash or modify subpoenas, 17 CFR § 201.232; and to oversee depositions, 17 CFR § 201.233. In short, ALJs are indistinguishable, for purposes of the Appointments Clause, from the judges found to be Officers in *Freytag*. *See SEC v. Duka*, No. 15 Civ. 00357 (Doc. 33), at 16 (April 15, 2015) ("The Supreme Court's decision in *Freytag* . . . would appear to support the conclusion that SEC ALJs are also inferior officers.")

In a trilogy of cases involving the constitutional status of military tribunals, the Supreme Court likewise has treated adjudicative officers as "Officers" for purposes of Article II, and the question addressed by the Court in such cases is frequently whether those officers are principal officers requiring direct Presidential appointment with the advice and consent of the Senate, or if they are inferior Officers subject to less stringent appointment restrictions. *See, e.g.*, *Weiss v. United States*, 510 U.S. 163, 169 (1994) ("[t]he parties do not dispute that military judges, because of the authority and responsibilities they possess, act as "Officers" of the United States") (citing *Freytag*, 501 U.S. 868; *Buckley*, 424 U.S. at 126); *Edmond v. United States*, 520 U.S.

651, 661-63 (1997) (evaluating whether military judges qualify as "principal" or "inferior" officers for purposes of Article II); *Ryder v. United States*, 515 U.S. 177, 180 (1995) (acknowledging lower court's determination "that appellate military judges are inferior officers").

3. The Finality of SEC ALJ Decisions

The "significant authority" exercised by SEC ALJs over the matters assigned to them is further augmented by the fact that they are able to issue findings and orders that become final, without the requirement of any further review by the Commission itself. Under the relevant provisions of the APA, an SEC ALJ is authorized to issue an "initial decision" that "becomes the decision of [the Commission] without further proceedings" unless the Commission affirmatively decides to review the decision in question and take action. 5 U.S.C. § 557(b). The SEC's Rules of Practice also provide that the Commission is not required to review an initial decision issued by an SEC ALJ, and that if the Commission declines to do so, the initial decision will be promulgated by the Commission as a final decision. 17 CFR § 201.360(d)(1), 17 CFR § 201.410, 17 CFR § 201.411. Once this process is complete, the federal securities laws provide that "the action of the . . . administrative law judge . . . shall, for all purposes, including appeal or review therefore, be deemed the action of the Commission." 15 U.S.C. § 78d-1(c). Given the practical realities of litigation in front of SEC ALJs — in which the majority of initial decisions issued by SEC ALJs become final decisions without additional review by the Commission — this structure grants additional plenary powers to SEC ALJs beyond those described above.

The SEC has argued in other cases that SEC ALJs are not inferior Officers subject to Article II because the decisions they issue are "only preliminary" because they are subject to further review by the Commission. *See, e.g.*, *Duka*, No. 15 Civ. 00357 (Doc. 13), at 13. But this argument ignores the fact that, as discussed, ALJ decisions can become final without further

review. In any event, the Supreme Court squarely rejected this same argument in *Freytag*: "The Commissioner reasons that special trial judges may be deemed employees . . . because they lack authority to enter a final decision. *But this argument ignores the significance of the duties and discretion that special trial judges possess.*" 501 U.S. at 881 (emphasis added).

The SEC has in other cases sought to avoid *Freytag* by citing to *Landry v. F.D.I.C.*, 204 F.3d 1125 (D.C. Cir. 2000), in which the D.C. Circuit held that FDIC ALJs were not officers subject to Article II. But the court in *Landry* distinguished *Freytag* based on two special factors peculiar to the FDIC regulatory regime, neither of which is present in this case. First, the court in *Landry* held that the "Tax Court [in *Freytag*] was required to defer to the STJ's factual and credibility findings unless they were clearly erroneous, . . . whereas here the FDIC Board makes its own factual findings" (i.e., conducts *de novo* review). 204 F.3d at 1133. Here, the Commission reviews factual findings for clear error, 17 CFR § 201.411(a)(2)(ii)(A), and thus this case falls squarely within *Freytag* and outside *Landry*. Second, the court in *Landry* found that "the STJs' power of final decision in certain classes of cases was critical to the [Supreme] Court's decision" in *Freytag*, and emphasized that the FDIC ALJ's could "never render the decision of the FDIC." 204 F.3d at 1134. But here the Commission's review of ALJs decisions is purely discretionary, and, absent the Commission's affirmative decision to review, are "deemed the action of the Commission." 15 U.S.C. § 78d-1(c); *cf.* 12 C.F.R. § 308.40 (contemplating mandatory, not discretionary, FDIC review). Thus, again, the facts here fall within *Freytag*, not *Landry*.

To the extent the Court reads *Landry* more broadly, it is inconsistent with *Freytag*, as D.C. Circuit Judge Randolph explained in his powerful concurrence, 204 F.3d at 1140-44 (Randolph, J., concurring). A broader reading of *Landry* is also inconsistent with binding

precedent in this Circuit. *Samuels, Kramer & Co. v. Comm'r*, 930 F.2d 975, 985-86 (2d Cir. 1991) (holding that the special trial judges are Article II officers without any reference to their ability to make final decisions). Finally, such a reading is inconsistent with guidance released by the Office of Legal Counsel for the Department of Justice, which has stated that "independent discretion is not a necessary attribute of delegated sovereign authority." Office of Legal Counsel, *Officers of the United States Within the Meaning of the Appointments Clause* (Apr. 16, 2007) (quotation marks omitted).[4] The Court should not adopt an interpretation of *Landry* that is inconsistent with Supreme Court precedent, Second Circuit precedent, and Executive Branch guidance.[5]

F. Disgorgement Order

In her initial decision, Judge Foelak ordered disgorgement of $3,953,609 jointly and severally against SHCH, SHCP and White. Initial Decision at 20. Judge Foelak made absolutely no attempt to determine what, if any, ill-gotten gains specifically went to White. Initial Decision at 20. Moreover, Judge Foelak did not deduct from her disgorgement order (1) the amounts paid directly from Rafferty to Rafferty's registered representatives who were employees of SHCP or (2) legitimate business expenses of SHCP. Initial Decision at 20 ("neither the commissions paid directly to SHCP employees, nor any other SHCP business expenses, will be omitted from the disgorgement total.").

---

[4] http://www.justice.gov/sites/default/files/olc/opinions/2007/04/31/appointmentsclausev10.pdf

[5] Notably, the Supreme Court explicitly declined to endorse the holding in *Landry* in a footnote to its decision in *Free Enterprise*, 561 U.S. at 507 n.10, while the dissenters flatly rejected the conclusions of the D.C. Circuit in that case. 561 U.S. at 542 (Breyer, J., dissenting) (quoting Justice Scalia's concurrence in *Freytag*, 501 U.S. at 878, finding that "[administrative law judges] are all executive officers.")

Disgorgement is an equitable remedy that Court's employ to deprive a "wrongdoer of his ill-gotten gain." *SEC v. ETS Payphone, Inc.*, 408 F.3d 727, 734 n. 6, 735 (11th Cir. 2005); *see also SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir.) ("Because disgorgement is remedial and not punitive, a court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing."). The purpose of disgorgement is to ensure that defendants are not unjustly enriched through their illegal trading activities. *See, e.g., SEC v. Blavin*, 760 F.2d 706, 710 (6th Cir.1985); *SEC v. Washington County Util. Dist.*, 676 F.2d 218, 222 (6th Cir.1982); *SEC v. Freeman*, 290 F.Supp.2d 401, 406 (S.D.N.Y.2003). Consequently, "federal courts have routinely ordered disgorgement of insider trading profits to ensure that defendants are not unjustly enriched by their illegal actions." *SEC v. Blackwell*, 477 F.Supp. at 891.

Payments from Rafferty to its registered representatives were undoubtedly legitimate payments and the Commission did not challenge them. As a matter of law those payments cannot be considered "ill-gotten gains" subject to a disgorgement order. As such, Judge Foelak's disgorgement order is incorrect as a matter of law.

Moreover, federal courts have allowed for the deduction of legitimate business expenses from a disgorgement order. *See SEC v. Thomas James Assoc., Inc.*, 738 F.Supp. 88, 89-90 (W.D.N.Y. 1990). In assessing disgorgement, the court in *Thomas James Assoc.*, deducted from its disgorgement order certain business expenses such as commissions, telephone charges and underwriting expenses. *Id.* at 92, 94-94. The court concluded that a reduction was appropriate "to reflect a fair setoff for necessary business expenses." *Id.* at 92.

A court is not required to order disgorgement, rather, "in the exercise of its equity powers a court *may* order disgorgement of *profits acquired through securities fraud.*" *SEC v. Patel*, 61

F.3d 137, 139 (2nd Cir.1995) (emphasis added); *see also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474-75 (2nd Cir.1996) ("The district court has broad discretion not only in determining whether or not to order disgorgement but also in calculating the amount to be disgorged."). Nonetheless, courts are only authorized to order disgorgement of illicit profits. *SEC v. Great Lakes Equities Co.*, 775 F.Supp. 211, 214 (E.D.Mich.1991). Consequently, courts cannot order the disgorgement of legitimate profits.

To the extent that disgorgement is warranted, only the net income received by SHCP should be disgorged (not gross trading revenues) as a significant amount of the trading revenue was used to pay legitimate business expenses and was paid directly to registered representatives of Rafferty (which even the Commission does not argue was inappropriate). Moreover, because the Commission did not introduce any evidence whatsoever as to how much money, if any, flowed to White, no disgorgement order should enter against White personally.

III. Conclusion

The Commission should grant the Respondents' petition for review, reverse the Initial Decision as to the issues set forth herein and dismiss this matter.

Respectfully Submitted,

SPRING HILL CAPITAL PARTNERS, LLC,
SPRING HILL CAPITAL MARKETS, L.L.C. and
KEVIN WHITE,

By Their Attorneys,

Ronald W. Dunbar, Jr.
Andrew E. Goloboy
Dunbar Law P.C.
197 Portland Street, 5th Floor
Boston, MA 02114
(617) 244-3550 (telephone)
(617) 248-9751 (facsimile)
dunbar@dunbarlawpc.com
goloboy@dunbarlawpc.com

Dated: December 21, 2015