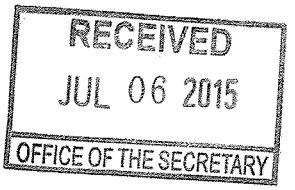
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16456

In the Matter of

Bama Biotech, Inc., *et al.*,

Respondents.

DIVISION OF ENFORCEMENT'S
BRIEF IN REPLY ON ITS MOTION FOR SUMMARY DISPOSITION

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I. Sino Clean Concedes the Relevant Facts are Undisputed, and these Facts Establish that Sino Clean's Registration Should be Revoked.

The Court should revoke the registrations of the securities of respondent Sino Clean Energy, Inc. ("Sino Clean") because it has failed to raise a genuine issue of any material fact regarding application of the factors laid out by the Commission in *Gateway Int'l Holdings, Inc.*, Securities Exchange Act of 1934 ("Exchange Act") Rel. No. 53907, at 10, 2006 SEC LEXIS 1288, at *19-20 (May 31, 2006) ("*Gateway*") (quoting *SEC v. Beisinger Indus. Corp.*, 552 F.2d 15, 18 (1st Cir. 1977)). Sino Clean concedes that the relevant facts are undisputed, and that the facts cited in the Division of Enforcement's brief are accurate. Sino Clean's Opposition ("Opp.") at 1. Sino Clean also does not dispute the Division's analysis of the *Gateway* factors that determine the appropriate sanction in this case. The facts establish that the Division is entitled, as a matter of law,

to an order revoking each class of securities of Sino Clean registered with the Commission pursuant to Exchange Act Section 12.

Revocation of Sino Clean's securities registration will protect the interests of current and future investors in the company, not harm them. In the Opposition brief, Sino Clean's court-appointed receiver has reported no progress in getting control of the company's books and financial information. Whenever the receiver is able to gain control of the company's books and financial information, he can file a new registration statement to re-register the company's securities. Until that time, revocation is the best protection for Sino Clean's current and future investors.

II. The Receiver's Appointments Clause Argument Fails Because SEC ALJs Are Not Inferior Officers Under Article II.

The receiver incorrectly asserts that this Court lacks the authority to grant the relief requested by the Division because Chief ALJ Brenda Murray—who is presiding over this proceeding—was not appointed in a manner consistent with the Appointments Clause of the Constitution. Opp. at 3-4. Assuming that Chief ALJ Murray was not hired through a process involving the approval of the Commissioners, her appointment was consistent with Commission ALJs' long-standing existence and function as Commission employees. Congress created and placed the ALJ position within the competitive service and granted the SEC discretion over whether and how to utilize ALJs. These facts, as well as the Commission's plenary authority over the administrative process, demonstrate that Chief ALJ Murray is an agency employee, not a constitutional officer, and her appointment therefore does not violate the Appointments Clause of the Constitution.

A. Background

At the SEC, as throughout the federal government, ALJs are civil service employees in the "competitive service" system. 5 C.F.R. § 930.201(b). The competitive service is the most basic category within the civil service; it includes positions such as corrections officers, human resources specialists, and paralegals, among others. *See* 5 U.S.C. § 2102; 5 C.F.R. § 212.101.

The Civil Service Reform Act of 1978 (the "CSRA"), 5 U.S.C. §§ 1101 *et seq.*, governs federal civil-service employment, including SEC ALJs' employment. *See, e.g.*, *Mahoney v. Donovan*, 721 F.3d 633, 635 (D.C. Cir. 2013). The CSRA regulates SEC ALJs' employment as it does that of other federal employees by, *inter alia*: setting merit systems principles to guide agency personnel management, 5 U.S.C. § 2301; describing the bases on which personnel actions against employees, including ALJs, are prohibited, *id.* § 2302; and specifying the administrative and judicial remedies available in response to such prohibited personnel practices, *id.* §§ 1204, 1212, 1214, 1215, 1221.

The Office of Personnel Management ("OPM"), which oversees federal employment for ALJs and other civil servants, administers a detailed civil service system for selecting ALJs, including conducting examinations for ALJ candidates, *see id.* §§ 1104, 1302; 5 C.F.R. §§ 930.201(d)-(e), 930.203; ranking ALJ applicants for placement on a register of eligible candidates according to their qualifications and numerical ratings, 5 U.S.C. § 3313; 5 C.F.R. § 332.401; and issuing "certificate[s] of eligibles" from which federal agencies—including the SEC—may select individuals to fill ALJ vacancies, 5 U.S.C. §§ 3317, 3318; 5 C.F.R. §§ 332.402, 332.404. OPM oversees each agency's "decisions concerning the appointment, pay, and tenure" of ALJs, *id.* § 930.201(e)(2),

and establishes classification and qualification standards for the ALJ positions, *id.* § 930.201(e)(3).

Like other employees, an ALJ who believes that his employing agency has engaged in a prohibited personnel practice can seek redress either through the Office of Special Counsel or the Merit Systems Protection Board ("MSPB"). *See* 5 U.S.C. §§ 1204, 1212, 1214, 1215, 1221. Pursuant to statute, "the agency in which [an] administrative law judge is employed"—here, the SEC—may propose certain specified personnel actions (*i.e.*, removal, suspension, etc.) against an ALJ. *Id.* § 7521; 5 C.F.R. §§ 930.211, 1201.137. The MSPB then decides, after an opportunity for a hearing, whether "good cause" exists to take the proposed personnel action. 5 U.S.C. § 7521(a). Finally, SEC ALJs are subject to agency reductions-in-force, again like other employees. *Id.* § 7521(b); 5 C.F.R. § 930.210.

The SEC has used ALJs since the Commission's early days. *See Charles Hughes & Co. v. SEC*, 139 F.2d 434 (2d Cir. 1943). The SEC's enabling statute provides the SEC discretion to use ALJs, permitting the SEC to delegate any of its functions to an ALJ provided that the agency "retain[s] a discretionary right to review" any delegated functions. 15 U.S.C. § 78d-1(a), (b); *see also* 5 U.S.C. § 3105. The SEC may appoint as many ALJs as is warranted. *See* 5 U.S.C. § 3105. Congress has not mandated that the SEC use ALJs; a "[h]earing officer" can be an ALJ, "a panel of Commissioners constituting less than a quorum of the Commission, an individual Commissioner, or any other person duly authorized to preside at a hearing." *See* 17 C.F.R. § 201.101(a)(5).

The Commission retains plenary authority to review any functions it delegates to an ALJ, *see* 15 U.S.C. § 78d-1, and all final agency determinations are those of the

Commission. The Commission may on its own motion order interlocutory review of any matter in a pending administrative proceeding. 17 C.F.R. § 201.400(a). An ALJ serving as a hearing officer prepares only an "initial decision." *Id.* § 201.360(a)(1). If a party does not seek further review and the Commission does not order review, then the Commission issues an "order of finality," specifying the date on which sanctions, if any, take effect. *Id.* § 201.360(d)(2).

Consistent with the Administrative Procedure Act ("APA"), in reviewing an ALJ's initial decision the Commission "retains 'all the powers which it would have in making the initial decision.'" *Nash v. Bowen*, 869 F.2d 675, 680 (2d Cir. 1989) (quoting 5 U.S.C. § 557(b)); 17 C.F.R. § 201.411(a). The Commission's review is *de novo*. It "may affirm, reverse, modify, [or] set aside" the initial decision, "in whole or in part," and it "may make any findings or conclusions that in its judgment are proper and on the basis of the record." The Commission may also "remand for further proceedings," *id.*, "remand . . . for the taking of additional evidence," or "hear additional evidence" itself, *id.* § 201.452. The ALJ's decision also has no effect if "a majority of participating Commissioners do not agree to a disposition on the merits." *Id.* § 201.411(f). And no appeal to federal court may be taken from an ALJ's initial decision: "a petition to the Commission for review of an initial decision is a prerequisite to the seeking of judicial review of a final order entered pursuant to such decision." *Id.* § 201.410(e).

B. SEC ALJs Are Employees, Not Inferior Officers.

The Appointments Clause of the Constitution mentions two categories of officers: principal officers and inferior officers. U.S. Const. art. II, § 2, cl. 2. Principal officers are selected by the President with the advice and consent of the Senate, while Congress

may "by law vest the appointment" of "inferior Officers" in "the President alone, in the Courts of Law, or in the Heads of Departments." *Id.*; *see Buckley v. Valeo*, 424 U.S. 1, 132 (1976). The Clause does not speak to the power to appoint employees who are not officers, and the requirements of the Clause are therefore not applicable to these individuals. *See Buckley*, 424 U.S. at 126 n.162; *Tucker v. Comm'r*, 676 F.3d 1129, 1132 (D.C. Cir. 2012).

The Supreme Court has held that whether government personnel are officers or employees is determined by "the manner in which Congress has specifically provided for the creation of the . . . positions, their duties and appointment thereto." *Burnap v. United States*, 252 U.S. 512, 516 (1920); *see also Freytag v. Comm'r*, 501 U.S. 868, 881 (1991). The Court has also held that government personnel qualify as officers only if they "exercis[e] significant authority pursuant to the laws of the United States," *Buckley*, 424 U.S. at 125-26, although the vast majority of personnel are employees, or "lesser functionaries subordinate to officers of the United States," *id.* at 126 & n.162; *see Free Enterprise Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 506 n.9 (2010); *United States v. Germaine*, 99 U.S. 508, 509 (1878).

As discussed below, even assuming that Chief ALJ Murray was not hired through a process involving the approval of the Commissioners, her appointment was consistent with Congress's and the Commission's treatment of ALJs as employees, and not constitutional officers. Congress's creation and placement of the ALJ position within the competitive service system, the SEC's discretion over whether and how to use ALJs, and the ALJs' subordinate role within the SEC's decision-making scheme all reflect that SEC ALJs are employees and that Congress intended ALJs to be so—a judgment that is

entitled to significant deference. Indeed, the only court of appeals to have directly addressed this question concluded that ALJs are employees—not officers. *Landry v. FDIC*, 204 F.3d 1125, 1132-34 (D.C. Cir. 2000).

1. This Court Should Defer to Congress's Judgment That ALJs Are Employees.

This Court should defer to Congress's long-standing judgment that ALJs are employees. *See Weiss v. United States*, 510 U.S. 163, 194 (1994) (Souter, J., concurring). The Constitution assigns to Congress the authority to determine, in the first instance, whether a position it creates is that of an officer or of an employee, *see* U.S. Const. art. II, § 2, cl. 2, and "[t]hat constitutional assignment to Congress counsels judicial deference," *In re Sealed Case*, 838 F.2d 476, 532 (D.C. Cir.) (Ginsburg, J., dissenting), *rev'd sub nom. Morrison v. Olson*, 487 U.S. 654 (1988). Congress's judgment "is owed a large measure of respect—deference of the kind courts accord to myriad constitutional judgments" made by the Legislative Branch. *Id.*[1]

Congress is presumed to know the requirements of the Appointments Clause. *E.g.*, *Cannon v. Univ. of Chicago*, 441 U.S. 677, 697 (1979). In fact, when Congress created the modern ALJ in 1946, the method of appointment generally determined the status—employee or officer—of the position. At that time, the Supreme Court had long characterized appointments pursuant to the methods prescribed in the Appointments Clause as a "well established definition of what it is that constitutes [an officer of the United States]." *United States v. Mouat*, 124 U.S. 303, 307 (1888). Congress specified

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

in the APA that it is the "agency"—not the President, the department head, or the Judiciary—that appoints ALJs, Pub. L. No. 79-404, 60 Stat. 237, 244; *see* 5 U.S.C. § 3105, indicating that Congress did not view ALJs as inferior officers. In the seven decades since the ALJs' creation, Congress has not changed ALJs' method of appointment (except in rare situations unique to an agency). Yet Congress knows how to comply with the Appointments Clause. *See* 5 U.S.C. § 2104(a)(1) (defining "officer" for certain statutory purposes, in part, on the basis of whether the individual is "required by law to be appointed" by the President, a court of the United States, the head of an Executive agency, or the Secretary of a military department); *see also, e.g.*, *Morrison*, 487 U.S. 654 (independent counsel, whom Congress specified must be appointed by the judiciary—namely a special panel of judges—pursuant to 28 U.S.C. § 49, is an "inferior officer"); *Kalaris v. Donovan*, 697 F.2d 376, 396 (D.C. Cir. 1983) (Department of Labor's Benefits Review Board members "are inferior officers of the United States, appointed by the Secretary of Labor").

Congress's judgment that ALJs are not officers is also reflected in Congress's having placed ALJs—along with tens of thousands of other federal employees—in the competitive service, which is the most basic category within the civil service system. *See Myers v. United States*, 272 U.S. 52, 173 (1926); 5 U.S.C. § 2102. The Supreme Court's examination of the Civil Service Commission's regulations of hearing examiners—the precursor of ALJs—was also consistent with the view that ALJs are not constitutional officers. *See Ramspeck v. Fed. Trial Exam'rs Conf.*, 345 U.S. 128, 130 (1953). Hearing examiners, like other government employees of that time period, were originally subject to the Classification Act of 1923 and dependent on their agency's ratings for

compensation and promotion. *Id.* In 1946, as a result of complaints about hearing examiners' perceived partiality, Congress enacted the APA and "separat[ed] adjudicatory functions and personnel from investigative and prosecution personnel in the agencies," by placing hearing examiners under the jurisdiction of the Civil Service Commission in a merit-based civil service system for federal employees, and by vesting the Civil Service Commission with control of the ALJs' compensation, promotion, and tenure. *See id.* at 131. Section 11 of the APA specified, for example, that hearing examiners were removable by the employing agency only for "good cause" established and determined by the Civil Service Commission. 60 Stat. at 244.

In enacting these measures, Congress gave no indication that it meant to elevate ALJs' status above that of the investigative and prosecution personnel of the agency. To the contrary, Congress explicitly "retained the examiners as classified Civil Service employees." *Ramspeck*, 345 U.S. at 133. Thus, on the question of whether hearing examiners' tenure protection precluded an agency from removing them due to a reduction in force, the Supreme Court said that "Congress intended to provide tenure for the examiners in the tradition of the Civil Service Commission," namely that "[t]hey were not to be paid, promoted, or discharged at the whim or caprice of the agency or for political reasons." *Id.* at 142. This meant that hearing examiners could be subject to the agency's reduction in force, like other employees. *Id.* at 140-41. The Court also found that the Civil Service Commission could set various salary grades to reflect the competence and experience of the examiners in each grade—again, like others in the civil service. *Id.* at 136.

Today, OPM is responsible for promulgating rules relating to ALJs and for administering the process by which ALJs are screened for positions across federal agencies. An agency may appoint an individual to an ALJ position only with prior approval of OPM, except when it makes its selection from the list of eligible ALJs provided by OPM. 5 C.F.R. § 930.204. The MSPB has jurisdiction over major personnel actions against ALJs. *See* 5 U.S.C. § 7521; 5 C.F.R. §§ 1201.137 *et seq*. The MSPB process is part of the Civil Service Reform Act's comprehensive remedial scheme for federal personnel disputes. *Gray v. Office of Pers. Mgmt.*, 771 F.2d 1504, 1510 (D.C. Cir. 1985) (refusing "to confer special status on ALJs beyond that expressly provided by Congress"). Congress provided no special remedial routes for ALJs to challenge most personnel disputes, even when the ALJ alleges interference with his decisional independence. *See, e.g.*, *Mahoney*, 721 F.3d at 636-37; *Brennan v. HHS*, 787 F.2d 1559, 1562-63 (Fed. Cir. 1986). Congress required that an ALJ's removal, suspension, reductions in grade or pay, and furlough of certain length be based on "good cause" established and determined by the MSPB, 5 U.S.C. § 7521, the same adjudicative body that handles employment disputes for other federal employees. In contrast, employees who occupy confidential, policy-determining, or policy-making positions in the "excepted service" may be removed without cause. *Id.* § 7511(b)(2); *see also id.* § 2302(a)(2)(B)(i).

In sum, SEC ALJs are not constitutional officers. And, at a minimum, Congress views them as standing on a different constitutional footing than inferior officers, who "determine[] the policy and enforce[] the laws of the United States." *Free Enterprise*, 561 U.S. at 484; *see id.* at 506-07 (noting that "[s]enior or policymaking positions in

government may be excepted from the competitive service to ensure Presidential control," and emphasizing that "nothing in [the Court's] opinion, therefore, should be read to cast doubt on the use of what is colloquially known as the civil service system within independent agencies").

2. SEC ALJs Have Only the Authority the SEC Delegates to Them and Do Not Have the Requisite "Significant Authority" to be Inferior Officers.

SEC ALJs are "lesser functionaries subordinate to officers of the United States." *Buckley*, 424 U.S. at 126 n.162. As the D.C. Circuit held in *Landry*, ALJs with the limited authority that SEC ALJs exercise are not inferior officers. 204 F.3d at 1133-34. There, the D.C. Circuit found that the FDIC's ALJs are not constitutional officers because they issue only recommended decisions and proposed orders and "can never render the decision of the FDIC"; "final decisions are issued only by the FDIC Board of Directors." *Id.* at 1133; *see also id.* at 1132 (FDIC ALJs possess "purely recommendatory power, *i.e.*, one followed . . . by de novo review"). Similarly here, the Commission has plenary authority over all administrative proceedings and only the Commission can issue a final decision. *See In re Mendenhall*, Exchange Act Release No. 74532, 2015 SEC LEXIS 1071, at *3 (Mar. 19, 2015) (The Commission "retains plenary authority over the course of its administrative proceedings and the rulings of its law judges—both before and after the issuance of the initial decision and irrespective of whether any party has sought relief."); *see also Nash*, 869 F.2d at 680 (The ALJ remains "subordinate to [the employing agency] in matters of policy and interpretation of law."); 17 C.F.R. § 201.101(a)(5). The Commission's review of an ALJ's decision is *de novo*, and the Commission has the power to "make any findings or conclusions that in its judgment are

proper and on the basis of the record," *id.* § 201.411(a), or to even "hear additional evidence" itself, *id.* § 201.452. Indeed, the ALJ's decision also has no effect if "a majority of participating Commissioners do not agree to a disposition on the merits." *Id.* § 201.411(f). Thus, under *Landry*, SEC ALJs are not officers. *See also Free Enterprise*, 561 U.S. at 507 n.10 (unlike PCAOB, many ALJs "possess purely recommendatory powers").

Freytag is not to the contrary. There, the Supreme Court held that special trial judges of the Tax Court are inferior officers, 501 U.S. at 880. But, as *Landry* expressly found, special trial judges are distinguishable from FDIC—and, by extension, SEC—ALJs because they are able to issue final decisions in certain categories of cases. *Landry*, 204 F.3d at 1134; *see also Freytag*, 501 U.S. at 882 (noting that IRS Commissioner had conceded that special trial judges "act as inferior officers"). Additionally, special trial judges have significant discretion in cases over which they do not have final decision-making authority, including the authority to make factual findings to which the Tax Court is required to defer, whereas neither the FDIC Board nor the Commission defers to ALJs' factual findings. *Landry*, 204 F.3d at 1133; 17 C.F.R. § 201.411(a).

A comparison of SEC ALJs' powers to the powers exercised by special trial judges underscores that SEC ALJs are rank-and-file government employees. Notably, the Tax Court exercises "a portion of the judicial power of the United States" pursuant to statute. *Freytag*, 501 U.S. at 891. The Supreme Court found it significant that the Tax Court closely resembles the federal district courts and exercises its judicial power in much the same way as the federal district courts exercise theirs. *Id.* And, like federal district courts, "[i]t has authority to punish contempts by fine or imprisonment," among

other things. *Id.* SEC ALJs, however, do not exercise any of the judicial power of the United States. Although they perform, in the most general sense, some of the same kinds of tasks as special trial judges, the substantive authority they exercise pales in comparison. For example, their power to punish contemptuous conduct is much more limited than that of special trial judges and does not include any ability to impose fines or imprisonment. *See* 17 C.F.R. § 201.180. And, while they may issue subpoenas, in cases of noncompliance, the agency would need to seek an order from a federal district court to compel compliance. *See* 15 U.S.C. § 78u(c). SEC ALJs are thus powerless to enforce the subpoenas they issue. *Id.*[2]

Conclusion

For the reasons set forth above, and in its initial papers, the Division respectfully requests that the Administrative Law Judge grant the Division's Motion for Summary Disposition and revoke the registration of each class of Sino Clean's securities registered under Exchange Act Section 12.

[2] As the receiver notes, a federal district court recently held that a plaintiff was likely to prevail on his Appointments Clause challenge to proceedings before an ALJ, finding that the role of the Commission's ALJs is not meaningfully distinguishable from that played by the special trial judges in *Freytag*. *Hill v. SEC*, No. 15-cv-1801 (N.D. Ga. June 8, 2015), ECF No. 28. This holding, which expressly rejects the D.C. Circuit's decision in *Landry*, is incorrect for the reasons discussed above. The Commission has filed an interlocutory appeal of the *Hill* ruling and has moved for a stay pending appeal. *See Hill v. SEC*, 15-12831 (11th Cir.).

Dated: July 6, 2015

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CERTIFICATE OF SERVICE

I hereby certify that true copies of the Division of Enforcement's Brief in Reply on its Motion for Summary Disposition were served on the following on this 6th day of July, 2015, in the manner indicated below:

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