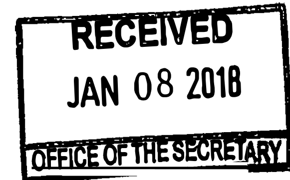
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17342



In the Matter of

RD LEGAL CAPITAL, LLC and
RONI DERSOVITZ

RESPONDENTS' RESPONSE TO COMMISSION'S NOVEMBER 30, 2017 ORDER

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I. INTRODUCTION

On November 29, 2017, the Solicitor General of the United States filed a brief with the United States Supreme Court on behalf of the Securities and Exchange Commission (the "Commission") in *Lucia v. SEC*, Case No. 17-130 (the "*Lucia* Brief"). In the *Lucia* Brief, the Commission disavows its longstanding position that its administrative law judges ("SEC ALJs") are "employees," rather than constitutional "officers," and thus are not subject to the Appointments Clause and vesting limitations in Article II of the Constitution. As this Court is aware, Respondents RD Legal Capital, LLC and Roni Dersovitz ("Respondents") had previously filed a motion to dismiss this administrative proceeding arguing that SEC ALJs are subject to the constitutional requirements of Article II, a view the Commission now agrees is correct. Respondents accordingly sent a letter on November 30, 2017, noting that the Commission's judicial admission that SEC ALJs are not appointed in conformity with the Constitution eliminated any opposition to Respondents' constitutional objections, and required the dismissal of this proceeding based on those objections.

The Commission's Division of Enforcement (the "Division") submitted a response on December 6, 2017 ("12/6/17 Letter") in which it claimed that "[n]one of Respondents' arguments in support of dismissal has merit." In its 12/6/17 Letter, the Division mischaracterized the Commission's position as reflected in the *Lucia* Brief in an attempt to minimize the significance of the Commission's reversal, and argued that any constitutional infirmity was cured by a general order the Commission issued on November 30, 2017 purporting to "ratify the agency's prior appointment" of SEC ALJs and instructing those SEC ALJs to in turn "[r]econsider" and either "ratify or revise" their prior decisions in all pending administrative proceedings (the "11/30/17 Order").

As explained below, however, the 11/30/17 Order fails to cure what the Commission now admits were constitutional defects in this administrative proceeding. First, the Commission's attempted "ratification" does not and cannot change the fact that the Commission violated the Appointments Clause when it forced Respondents to participate in an administrative proceeding before an administrative law judge who had not been properly appointed by the Commission. Second, the Commission's 11/30/17 Order does not even address, let alone attempt to rectify, separation of powers problems arising from the multi-layer tenure protection afforded to SEC ALJs. Given the Commission's admission that SEC ALJs are "inferior officers," that multi-layer protection from removal violates Article II's requirement that executive power be vested in the President. That separate constitutional defect is not cured by any "ratification" on the part of the Commission.

Because the 11/30/17 Order does not and cannot remedy the original Appointments Clause defect or the separate violation of Article II's vesting limitations, Respondents renew their request that the Court dismiss this proceeding.

II. THE 11/30/17 ORDER DOES NOT CURE WHAT THE COMMISSION NOW CONCEDES WERE APPOINTMENTS CLAUSE VIOLATIONS

The Commission seeks by its 11/30/17 Order "[t]o put to rest any claim that administrative proceedings pending before, or presided over by, Commission administrative law judges violate the Appointments Clause" (11/30/17 Order at 1), and employs two separate "ratification" strategies to achieve its objective. First, the 11/30/17 Order states that "the Commission—in its capacity as head of a department—hereby ratifies the agency's prior appointment of Chief Administrative Law Judge Brenda Murray and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes, and Jason S. Patil." (*Id.*) Second, the

11/30/17 Order requires all SEC ALJs presiding over pending matters to "[r]econsider the record" and to "[d]etermine, based on such reconsideration, whether to ratify or revise in any respect all prior actions taken by an administrative law judge in the proceeding . . . ." As explained below, however, neither the Commission nor this Court has the authority to ratify what the Commission now concedes were structural violations of the Appointments Clause. *See Edmond v. United States*, 520 U.S. 651, 659 (1997) ("[T]he Appointments Clause of Article II is more than a matter of 'etiquette or protocol'; it is among the significant structural safeguards of the constitutional scheme.") (citing *Buckley v. Valeo*, 424 U.S. 1, 125 (1976) (*per curiam*)).[1]

A. The Commission Cannot Retroactively Convert A Hiring To An Appointment

The Commission's attempt to cure the Appointments Clause violation by "ratif[ying] the agency's prior appointment" of SEC ALJs must fail because, as the Commission itself has conceded, none of the SEC ALJs were ever "appointed" by the agency. The administrative law judges currently employed by the Commission instead were vetted through a competitive examination process conducted by the Office of Personnel Management, and ultimately were selected not by the Commission, but by the chief administrative law judge, "subject to approval by the Commission's Office of Human Resources on the exercise of authority *delegated* by the Commission." (Lucia Brief at 3 (emphasis added); *see also id.* at 19.)[2] Contrary to its claim in

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[1] Of course, even prior to filing this action, the Division was well aware of the multiple pending Appointments Clause challenges to SEC administrative proceedings. Instead of filing this case in federal court and avoiding those issues, however, the Division knowingly commenced this administrative proceeding, fought Respondents' constitutional challenges in this Court and in federal court, and assumed the risk that the Appointments Clause issue would ultimately be decided against the Commission. As explained herein, having assumed that risk and subjected RD Legal to a prolonged proceeding that lacked the constitutional safeguards mandated by Article II, the Commission cannot wipe away its own constitutional violation with a simple stroke of the pen. Our Constitution demands more.

[2] The Court should reject outright the Commission's disingenuous attempt in its 11/30/17 Order to distance itself from the positions it took in the *Lucia* Brief. (*See* 11/30/17 Order at 1

the 11/30/17 Order, the Commission's effort to retroactively convert what it has admitted was a constitutionally infirm delegation of hiring authority into a constitutionally permissible appointment process would not be a ratification of the Commission's prior acts, but rather a *mischaracterization* of those acts.[3] A ratification can confirm that an apple is an apple, but it cannot transform an apple into an orange.

Indeed, because its prior delegation of hiring authority is the very thing that the Appointments Clause prohibits, the Commission does not have the power to ratify such improper delegation retroactively. The Supreme Court has recognized that "it is *essential* that the party ratifying should be able . . . *to do the act ratified*," both "at the time the act was done" and "*at the time the ratification was made*." *FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98 (1994) (first emphasis added) (quoting *Cook v. Tullis*, 85 U.S. (18 Wall.) 332, 338 (1874)). In *NRA Political Victory Fund*, the Supreme Court rejected the Solicitor General's attempt to ratify the filing of a *certiorari* petition by the Federal Election Commission on the ground that the Solicitor General itself lacked authority at the time of its purported ratification to do the act that it sought to ratify. *See* 513 U.S. at 98 ("Here, the Solicitor General attempted to ratify the FEC's filing on May 26, 1994, but he could not himself have filed a petition for certiorari on that date because the 90–day time period for filing a petition had expired on January 20, 1994. His authorization simply came too late in the day to be effective.").

As in *NRA Political Victory Fund*, the Commission here itself lacks the authority to do the act it seeks to ratify—*i.e.*, delegation of the selection and hiring of SEC ALJs to others. The

(suggesting that positions taken in the *Lucia* Brief belonged to the Solicitor General rather than to the Commission on whose behalf the *Lucia* Brief was filed).

[3] Of course, had there been a prior appointment of the SEC ALJs, the Commission would not have needed to vehemently argue for years that SEC ALJs were "employees" who did not need to be appointed in accordance with Article II.

Commission's attempt in the 11/30/17 Order to accomplish through retroactive "ratification" that which it lacks the constitutional authority to do in the first place accordingly must be rejected. *See Newman v. Schiff*, 778 F.2d 460, 467 (8th Cir. 1985) ("Ratification serves to authorize that which was unauthorized. Ratification cannot, however, give legal significance to an act which was a nullity from the start.").

None of the cases upon which the Division relies in its 12/6/17 Letter compels a contrary result. In each of the cases the Division cites, the Appointments Clause violation was cured not through a retroactive ratification of a *defective prior* "appointment" (as the Commission improperly attempts to do in its 11/30/17 Order), but rather through a two-step process in which a *valid subsequent* appointment permitted the now properly appointed officer to ratify prior unauthorized acts. In *Consumer Finance Protection Bureau v. Gordon*, for example, Director Richard Cordray was not able to ratify his prior unauthorized acts as Director of the Consumer Finance Protection Bureau until he was subsequently confirmed by the Senate.[4] *CFPB v. Gordon*, 819 F.3d 1179, 1185-86 (9th Cir. 2016); *see id.* at 1190–91 ("The initial invalid appointment of Cordray also is not fatal to this case. The *subsequent valid appointment*, coupled with Cordray's August 30, 2013 ratification, cures any initial Article II deficiencies.") (emphasis added).

Similarly, each of the three D.C. Circuit ratification cases the Division cites in its 12/6/17 Letter involved ratification of prior acts *following* a subsequent valid appointment, *not* the ratification of a prior hiring or "appointment" that was made in violation of the Appointments Clause. *See Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 117 (D.C.

[4] Notably, the Senate did not seek to ratify Director Cordray's previous improper recess appointment—the equivalent of what the Commission is attempting to do here. The Senate instead undertook a constitutional appointment process, and Director Cordray, once properly appointed, was then able to ratify his prior unauthorized acts.

Cir. 2015) ("Intercollegiate does not dispute that the three new Judges were properly appointed by the Librarian under the Appointments Clause."); *Doolin Sec. Sav. Bank, F.S.B. v. Office of Thrift Supervision*, 139 F.3d 203, 213-14 (D.C. Cir. 1998) (holding that a *validly appointed agency director* had "made a detached and considered judgment" in ratifying the previous director's decision); *FEC v. Legi-Tech*, 75 F.3d 704, 706 (D.C. Cir.1996) (holding that a *properly reconstituted* Federal Election Commission could reauthorize pending enforcement actions that had been initiated by an unconstitutionally constituted Commission).

These cases accordingly provide no support for the Commission's improper effort to retroactively ratify a selection and hiring process for SEC ALJs that even the Commission concedes violated the Appointments Clause, and Respondents are unaware of any case holding that an Appointments Clause violation can be cured in the absence of a subsequent valid appointment. As explained below, the 11/30/17 Order does not effect a subsequent valid appointment of the SEC ALJs, and even if it did, this Court would still need to dismiss this proceeding as constitutionally untenable.

B. The 11/30/17 Order Fails To Appoint The SEC ALJs In The Manner Required By The Appointments Clause

Respondents recognize that the Commission has authority as the "head of a department" to appoint SEC ALJs in conformity with the Appointments Clause. The Commission, however, has not yet exercised that authority. As discussed above, the 11/30/17 Order instead improperly attempts to ratify a prior act that—as the Commission itself concedes—violated the Appointments Clause. While the 11/30/17 Order goes on to instruct this Court and the other SEC ALJs to "[r]econsider" and "ratify or revise" all prior actions, it *fails to appoint* the SEC ALJs in the manner required by the Appointments Clause, and thus never imbues the SEC ALJs

with the authority necessary to engage in that process. Moreover, as explained below, even if the Commission were to subsequently exercise its authority to appoint the SEC ALJs, this Court would still be obligated to dismiss this action.

C. Even If The Commission Properly Appointed The SEC ALJs, This Action Would Still Need To Be Dismissed

Respondents do not dispute that a properly appointed official can revisit and ratify prior actions taken by an improperly appointed official. The "ratifier," however, cannot just "blindly affirm the earlier decision without due consideration," but instead "must make a detached and considered affirmation of the earlier decision." *Advanced Disposal Servs. E., Inc. v. NLRB*, 820 F.3d 592, 602-03 (3d Cir. 2016); *see also Wilkes-Barre Hosp. Co., LLC v. NLRB*, 857 F.3d 364, 371 (D.C. Cir. 2017) ("Our precedents establish that ratification can remedy a defect arising from the decision of 'an improperly appointed official . . . when . . . a properly appointed official *has the power to conduct an independent evaluation of the merits and does so.*'") (emphasis added) (quoting *Intercollegiate Broad. Sys*, 796 F.3d at 117-21, 124).

Here, an independent evaluation of the merits of the "Motion To Dismiss Unconstitutional Proceeding" that Respondents filed on March 8, 2017 (the "Constitutionality Motion") would require the Court to grant the Constitutionality Motion and dismiss these tainted proceedings. As the Court is aware, Respondents argued in their Constitutionality Motion that this administrative proceeding had to be dismissed because, *inter alia*, the administrative law judge presiding over the proceeding had not been appointed in conformity with the Appointments Clause. (*See* Constitutionality Motion at 5-13.) At the time, the Court rejected Respondents' Appointments Clause challenge on the ground that it lacked authority to contravene the Commission's prior determination that SEC ALJs were not "inferior officers"

subject to the Appointments Clause. (Trial Transcript at TR6814:13-16.) Now, however, the Commission has reversed its position, and agrees with Respondents that this administrative proceeding was presided over by an "inferior officer" who was not appointed in conformity with the Appointments Clause.

Courts, including the Supreme Court, have recognized that proceedings before an improperly appointed judge must be set aside. *See, e.g., Ryder v. United States*, 515 U.S. 177, 188 (1995) (reversing judgment by Coast Guard Court of Military Review based on Appointments Clause violation and holding that "[p]etitioner is entitled to a hearing before a properly appointed panel of that court"); *Nguyen v. United States*, 539 U.S. 69, 77-83 (2003) (rejecting the "*de facto* officer" doctrine and vacating judgments based on determination that a Ninth Circuit panel consisting of two Article III judges and one Article IV judge lacked authority to decide the appeals); *see also Bandimere v. SEC*, 844 F.3d 1168, 1172, 1188 (10th Cir. 2016) (setting aside Commission's opinion based on Appointments Clause violation and recognizing that resolving the Appointments Clause challenge in petitioner's favor "relieves Mr. Bandimere of all liability") (petition for writ of *certiorari* pending).

The Division does not dispute in its 12/6/17 Letter that proceedings before an unconstitutionally appointed officer are improper, but argues that "the ratification process renders any purported error harmless." (12/6/17 Letter at 1-2.) As discussed above, however, the Commission cannot simply invoke "ratification" to retroactively convert a hiring process that indisputably violated the Appointments Clause into a completely different—and constitutionally permissible—appointment process. And any *subsequent* valid appointment would not change the fact that, at the time Respondents' Constitutionality Motion was brought, this Court had not been appointed in the manner required by the Appointments Clause, and the Constitutionality

Motion therefore *should have been granted.* As a result, even if the Court now had the authority to reconsider its prior invalid rulings, it could not ratify its prior denial of the Constitutionality Motion, but instead would have to grant that motion based on the undisputed fact that the Court had not been properly appointed when it was brought.

III. THE 11/30/17 ORDER DOES NOT EVEN ATTEMPT TO CURE THE SEPARATION OF POWERS VIOLATION

In addition to failing to cure the Appointments Clause violation, the Commission's 11/30/17 Order does not address, let alone attempt to remedy, the separation of powers infirmity caused by the multi-layers of tenure protection afforded to SEC ALJs. *See Free Enter. Fund v. PCAOB*, 561 U.S. 477, 492 (2010) (holding that "the dual for-cause limitations on the removal of Board members contravene the Constitution's separation of powers").

Article II of the Constitution vests executive power in the President, who must "take Care that the Laws be faithfully executed." U.S. Const. art. II, § 1, cl. 1; *id.* § 3. In discharging this duty, the Constitution authorizes the President to rely on the assistance of executive officers. *Free Enter. Fund*, 561 U.S. at 483. "In order to maintain control over the exercise of executive power and take care that the laws are faithfully executed," Article II's vesting authority requires that the principal and inferior officers of the executive branch be answerable to the President and not be separated from the President by attenuated chains of democratic accountability. *PHH Corp. v. CFPB*, 839 F.3d 1, 13 (D.C. Cir. 2016) ("[T]he President must be able to remove those officers at will.") (reh'g *en banc* granted).

Specifically, as the Supreme Court held in *Free Enterprise Fund*, Article II requires that executive officers not be protected from removal by their superiors at will, when those superiors are themselves protected from removal by the President at will. 561 U.S. at 483-84 (holding that

("multilevel protection from removal is contrary to Article II's vesting of the executive power in the President"). Because the Commission now recognizes that SEC ALJ are executive officers rather than employees (*see Lucia* Brief at 10 ("The Commission's ALJs Are Officers Of the United States Rather Than Employees")), those judges may not be protected by more than one layer of good-cause removal protection.

SEC ALJs, however, enjoy *multiple* layers of protection from removal in violation of this bright-line rule:

- First, SEC ALJs are protected by statute from removal absent "good cause." 5 U.S.C. § 7521(a).

- Second, members of the Merits Systems Protection Board ("MSPB")—who determine whether sufficient "good cause" exists to remove the Commission's administrative law judges—are also protected by tenure. They too are removable by the President "only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d); *see also* 5 C.F.R. § 930.211(a) ("An agency may remove . . . an administrative law judge only for good cause established and determined by the [MSPB] . . . .").

- Third, the SEC Commissioners, who exercise the power of removal after a "good cause" determination is made by the MSPB, are themselves protected by tenure. They may not be removed by the President from their position except for "inefficiency, neglect of duty, or malfeasance in office." *See, e.g.*, *Free Enter. Fund*, 561 U.S. at 487 (citation omitted); *MFS Sec. Corp. v. SEC*, 380 F.3d 611, 619-20 (2d Cir. 2004) (citation omitted).

This multi-layer good-cause removal protection is analogous to the tenure structure that was held to violate Article II in *Free Enterprise Fund.* Indeed, like its counterpart in that case, the removal scheme here impairs the President's ability to ensure that the laws are faithfully executed, and accordingly violates principles of separation of powers. *See Free Enter. Fund*, 561 U.S. at 498. Because the President cannot oversee SEC ALJs in accordance with Article II, administrative proceedings presided over by those judges violate the Constitution.

Although the Commission's 11/30/2017 Order seeks to remedy the Appointments Clause violations discussed above, it fails even to address this Article II removal issue. The Division accordingly cannot look to the 11/30/2017 Order to resolve this distinct separation of powers infirmity. In its 12/6/17 Letter, the Division instead argues that the Commission foreclosed a constitutional challenge to the multi-layers of tenure protection afforded to SEC ALJs in *In re Timbervest, LLC*, Investment Advisers Act Release No. 4197, 2015 WL 5472520 (Sept. 17, 2015). The *Timbervest* decision, however, is currently on appeal to the D.C. Circuit (*see Timbervest, LLC v. SEC*, D.C. Circuit, Case No. 15-1416) and, in any event, much of its reasoning has now been undermined by the *Lucia* Brief, in which the Commission recognized that the status of SEC ALJs as executive officers implicates *Free Enterprise Fund*'s prohibition on multi-layers of tenure protection, and thus abandoned much of the reasoning in *Timbervest*'s constitutional analysis. (*See Lucia* Brief at 10-11.)

Notwithstanding *Timbervest*'s limited remaining precedential value, *if any*, the Division's 12/6/17 Letter still clings to *Timbervest's* erroneous reasoning. First, the Division states that SEC ALJs' duties differ from the PCAOB's duties because SEC ALJs perform adjudicative, rather than enforcement or policy-making functions. (12/6/17 Letter at 2 (citing *Timbervest, LLC*, Investment Advisers Act Release No. 4197, 2015 WL 5472520, at *27).) In *Morrison v. Olson*, 487 U.S. 654 (1988), however, the Supreme Court considered and rejected the notion that the President's removal authority operates less stringently for quasi-judicial and quasi-legislative officers than for officers with "purely executive" functions. *Id.* at 689 ("[T]he president's power to remove an official cannot be made to turn on whether or not that official is classified as 'purely executive.'"). The proper inquiry thus is not the nature of the executive officer'se responsibilities, but rather whether the multi-layers of removal restrictions impede the

President's ability to perform his constitutional duty. Here, that inquiry leads to the same result reached in *Free Enterprise Fund*: multiple layers of tenure protection improperly insulate SEC ALJs from democratic accountability.

Second, the Division tries to distinguish the authority granted to SEC ALJs from the authority that was granted to the PCAOB. But this argument is no more than a rehash of the "significant authority" test under which, as the Commission now concedes, administrative law judges are executive officers, not employees. (*See Lucia* Brief at 10 ("[T]he government is now of the view that such ALJs are officers because they exercise 'significant authority pursuant to the laws of the United States.'") (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976) (per curiam)).) Because SEC ALJs exercise significant authority, they are inferior officers, and therefore are subject to the removal limitations recognized in *Free Enterprise Fund.*

Finally, the Division quotes *Timbervest* to argue that, "unlike the structure of the PCAOB, the ALJ system is not novel and has been in place for over 70 years." (12/6/17 Letter at 2 (quoting *Timbervest*, at *28).). But *Timbervest* incorrectly asserts that the system of appointment and removal applicable to SEC ALJs has "been in place since the Administrative Procedure Act was enacted in 1946." *In re Timbervest, LLC*, Release No. 4197, 2015 WL 5472520, at *28. In reality, under the laws in effect at the time of the enactment of the Administrative Procedure Act, the for-cause removal of an ALJ was reviewed by the U.S. Civil Service Commission. *See* Pendleton Civil Service Reform Act, 22 Stat. 403 (1883). It was not until the Civil Service Reform Act of 1978 that the two layers of for-cause removal were added; and it was not until 2010, with its decision in *Free Enterprise Fund*, that the Supreme Court considered the constitutionality of multi-layers of tenure protection. 561 U.S. at 483-84. In any

event, the length of time that an unconstitutional practice has been in place is irrelevant to its constitutionality.

IV. CONCLUSION

"Ratification" is not a magical incantation that can be wielded indiscriminately to transform what the Commission now concedes was a constitutionally improper hiring process into a proper exercise of the Commission's authority under the Appointments Clause. And while the Commission could exercise that authority to make a *subsequent* valid appointment of SEC ALJs—which the 11/30/17 Order does not do—this Court cannot ratify its prior denial of Respondents' Constitutionality Motion because, as the Commission now admits, that motion was meritorious at the time it was brought and correctly argued that this administrative proceeding violates the Constitution.

Prior to the passage in 2010 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), the Commission was statutorily prohibited from bringing administrative proceedings seeking financial penalties against unregistered entities such as Respondents. By expanding the Commission's authority to initiate administrative proceedings, Dodd-Frank exacerbated the inherent tension between the need for an independent adjudicator and the need for democratic accountability in the exercise of executive power. Any conflict between these two constitutional principles does not, however, allow the Commission simply to ignore the constitutional limits on appointments and removal imposed by Article II. Indeed, the Commission could have avoided this whole constitutional morass just by doing what it should have done all along—*i.e.*, bringing this case in federal court before an Article III judge with lifetime tenure. It cannot, however, maintain this proceeding without resolving the constitutional infirmities created by SEC ALJs' status as executive officers, which the 11/30/17 Order fails to

do. Respondents therefore respectfully submit that this Court must dismiss this administrative proceeding based on its incurable constitutional defects.

Dated: January 5, 2018

Respectfully submitted,

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