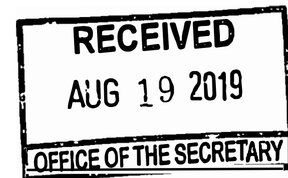
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of,
David Pruitt, CPA
Respondent.



RESPONDENT DAVID PRUITT'S MOTION TO DISMISS THIS ADMINISTRATIVE PROCEEDING FOR CONSTITUTIONAL VIOLATIONS AND MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

Respondent David N. Pruitt ("Mr. Pruitt") respectfully moves for dismissal of the April 28, 2017 Order Instituting Proceedings ("OIP"), as amended on April 26, 2019,[1] against him based on the constitutional defenses and violations asserted herein.[2]

PRELIMINARY STATEMENT

Mr. Pruitt moves for dismissal of these administrative proceedings on two constitutional grounds, one of which has been advanced by the Securities and Exchange Commission (the "Commission") itself before the Supreme Court.

First, as the Commission itself has recognized, the statutory constraints on removing Commission Administrative Law Judges ("ALJ") from service unconstitutionally impair the President's duty to faithfully execute the laws. Commission ALJs are subject to two or even three layers of insulation from presidential control and removal, which exceeds the stringent removal protections held to be unconstitutional in *Free Enter. Fund v. PCAOB*, 561 U.S. 477 (2010). Mr. Pruitt is therefore entitled to relief from proceedings conducted by an official exercising unlawful authority.

Second, these administrative proceedings violate Mr. Pruitt's Seventh Amendment right to trial by jury. Actions for civil penalties involve private rights of the sort "traditionally available only in a court of law" and are therefore subject under the Seventh Amendment "to a jury trial on demand." *See Tull v. United States*, 481 U.S. 412, 423 (1987). The Commission's action to deprive Mr. Pruitt of that right by pursuing administrative adjudication is unlawful.

Accordingly, the Constitution demands that these proceedings be dismissed.

[1] Order Granting Motion to Amend Order Instituting Proceedings, Admin. Proc. Rulings Release No. 6551, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950 (Apr. 26, 2019).

[2] Mr. Pruitt has asserted numerous affirmative defenses, of which this motion addresses only several. Mr. Pruitt does not waive and expressly reserves his right to assert other affirmative defenses.

ARGUMENT

I. THE ADMINISTRATIVE PROCEEDING IS UNCONSTITUTIONAL BECAUSE REMOVAL RESTRICTIONS VIOLATE THE SEPARATION OF POWERS

The statutory constraints on removing Commission ALJs from service unconstitutionally impair the President's duty to faithfully execute the laws. For that reason, these proceedings are unlawful and must be dismissed.

In its briefing in *Lucia v. SEC*, the Commission itself identified that precise impairment as raising "serious constitutional concerns." Resp. Br. at 39, *Lucia v. SEC*, No. 17-130 (Feb. 21, 2018). By vesting in the President "[t]he executive Power" of the United States, U.S. Const. Art. II, § 1, cl. 1, and charging him with the duty to "take Care that the Laws be faithfully executed," *id.* § 3, Article II of the Constitution "confers on the President 'the general administrative control of those executing the laws.'" *Free Enter. Fund*, 561 U.S. at 492 (quoting *Myers v. United States*, 272 U.S. 52, 164 (1926)). And the President's "ability to execute the laws" is inextricably linked to his authority to "hold[] his subordinates accountable for their conduct." *Id.* at 496. The Constitution therefore gives the President what the Framers saw as the "traditional" means of ensuring accountability: the "power to oversee executive officers through removal." *Id.* at 492. The President's removal power is a necessary consequence of the Executive's constitutional obligation to faithfully execute the laws. *Id.* at 484; *Myers*, 272 U.S. at 119 ("power of removal of executive officers was incident to the power of appointment"). On that basis, *Free Enterprise Fund* struck down a statutory provision that imposed stringent limitations on the removal of inferior officers within an agency whose principal officers were themselves assumed to be subject to strict removal restrictions. *Free Enter. Fund*, 561 U.S. at 496.

As the Commission itself argued in *Lucia*, the statutory constraints on removal of Commission ALJs suffer from the same constitutional defect.[3] Commission ALJs are "Officers of the United States." *Lucia*, 138 S. Ct. at 2057 (Thomas, J., concurring). Yet the Administrative Procedure Act provides that ALJs (including Commission ALJs) may be removed by an agency head "only for good cause established and determined by the Merit Systems Protection Board," 5 U.S.C. § 7521(a), whose members are themselves removable by the President "only for inefficiency, neglect of duty, or malfeasance in office," 5 U.S.C. § 1202(d). Moreover, the Commission itself (the agency head here) lacks independent authority to remove Commission ALJs for misconduct or for failure to follow lawful instructions or perform adequately, instead requiring the concurrence of the Board. And members of the Commission are removable by the President only for good cause and are not "subject to the President's direct control." *Free Enter. Fund*, 561 U.S. at 495.

While even a single layer of insulation from presidential control and removal would impinge presidential authority, Commission ALJs are insulated from removal by the President twice or even thrice over. "This violates the basic principle that the President cannot delegate ultimate responsibility or the active obligation to supervise that goes with it, because Article II makes a single President responsible for the actions of the Executive Branch." *Id.* at 496–97 (internal quotation marks and citation omitted). The removal protections afforded to Commission ALJs are unconstitutional.

The Supreme Court has held that "one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case" is entitled to relief. *Ryder v.*

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[3] The Supreme Court declined to decide the issue, on the ground that it had not been addressed by any lower court. *Lucia v. SEC*, 138 S. Ct. 2044, 2050 n.1 (2018).

United States, 515 U.S. 177, 182–83 (1995); *see also Lucia*, 138 S. Ct. at 2055 (holding same); *Free Enter. Fund*, 561 U.S. at 513 (finding similarly situated party entitled to "declaratory relief sufficient to ensure that the [challenged actions] to which they are subject will be enforced only by a constitutional agency accountable to the Executive"). In this instance, Mr. Pruitt is entitled to be free from proceedings conducted by an official exercising unlawful authority. The Constitution therefore requires that these proceedings be dismissed.

II. THE ADMINISTRATIVE PROCEEDING IS UNCONSTITUTIONAL BECAUSE MR. PRUITT IS ENTITLED TO TRIAL BY JURY

These proceedings also unconstitutionally impinge Mr. Pruitt's right to trial by jury and therefore must be dismissed.

The Seventh Amendment provides that "[i]n suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved." U.S. Const., amend. VII. The Supreme Court has "consistently interpreted the phrase 'Suits at common law' to refer to suits in which *legal* rights were to be ascertained and determined, in contradistinction to those where equitable rights alone were recognized, and equitable remedies were administered." *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 41 (1989) (internal quotation marks and citation omitted). Suits subject to the Seventh Amendment jury right include "actions brought to enforce statutory rights that are analogous to common-law causes of action ordinarily decided in English law courts in the late 18th century, as opposed to those customarily heard by courts of equity or admiralty." *Id.* at 42. To determine on which side of the line a particular action falls requires consideration, first, of how the action compares "to 18th-century actions brought in the courts of England prior to the merger of the courts of law and equity" and, second, of "whether [the remedy sought] is legal or equitable in nature." *Tull*, 481 U.S. at 417–18.

As to the first inquiry, it is well established that civil penalty actions like this one are analogous to legal actions, requiring trial by jury, under the common law of England. "English courts had held that a civil penalty suit was a particular species of an action in debt that was within the jurisdiction of the courts of law." *Id.* at 418. Moreover, "[a]fter the adoption of the Seventh Amendment, federal courts followed this English common law in treating the civil penalty suit as a particular type of an action in debt, requiring a jury trial." *Id.* (citing authorities). Thus, as the Supreme Court has recognized, "[a]ctions by the Government to recover civil penalties under statutory provisions therefore historically have been viewed as one type of action in debt requiring trial by jury." *Id.* at 418–19.

As to the second inquiry, it is equally well established that "[a] civil penalty was a type of remedy at common law that could only be enforced in courts of law." *Id.* at 422. "Remedies intended to punish culpable individuals, as opposed to those intended simply to extract compensation or restore the status quo, were issued by courts of law, not courts of equity." *Id.* No different than the Clean Water Act civil penalty at issue in *Tull*, the civil penalty at issue here, "exacts punishment—a kind of remedy available only in courts of law." *Id.* at 422 n.7; *see also* 15 U.S.C. § 78u-2(c) (directing Commission to consider need for retribution and deterrence in imposing penalties). Accordingly, as in *Tull*, "[b]ecause the nature of the relief [sought here] was traditionally available only in a court of law," Mr. Pruitt "is entitled to a jury trial on demand," *Tull*, 481 U.S. at 423, rather than being subjected to administrative adjudication.[4]

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[4] That the OIP asserts equitable penalties in addition to civil penalties does not affect Mr. Pruitt's Seventh Amendment rights. "Where, as here, a legal claim is joined with an equitable claim, the right to jury trial on the legal claim, including all issues common to both claims, remains intact." *SEC v. Jensen*, 835 F.3d 1100, 1106 (9th Cir. 2016) (internal quotation marks omitted).

Finally, it bears noting that, when Congress authorized the Commission to seek penalties through administrative adjudication, it did not create a new cause of action that might arguably involve a new "public right" exempt from the Seventh Amendment jury right. Instead, it authorized the Commission to bring actions under the preexisting enforcement provisions before an administrative tribunal. And that distinction makes all the difference. *See Granfinanciera, S.A.*, 492 U.S. at 60 ("The decisive point is that [Congress did not] 'creat[e] a new cause of action, and remedies therefor, unknown to the common law,' because traditional rights and remedies were inadequate to cope with a manifest public problem") (quoting *Atlas Roofing Co. v. Occupational Safety & Health Comm'n*, 430 U.S. 442, 461 (1977)). Given that, under *Tull*, the preexisting action for civil penalties was indisputably subject to the Seventh Amendment jury right, *see, e.g.*, *SEC v. Capital Sols. Monthly Income Fund, LP*, 818 F.3d 346, 354–55 (8th Cir. 2016); *SEC v. Lipson*, 278 F.3d 656, 662 (7th Cir. 2002), permitting the assignment of such actions to administrative tribunals where a jury trial is not possible, necessarily contravenes the Seventh Amendment.

CONCLUSION

For the foregoing reasons, Mr. Pruitt respectfully requests that the Court grant this motion to dismiss these proceedings.

Dated: August 14, 2019
New York, New York

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August 14, 2019

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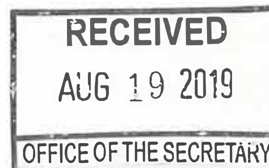
VIA U.S. MAIL



Honorable Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: In the Matter of David Pruitt:
Admin. Proc. File No. 3-17950

Dear Ms. Countryman:

Enclosed please find the original and three hard copies of the Notice of Appearance of Andrew M. Grossman in the above-referenced matter.

Respectfully submitted,

Bari R. Nadworny
Associate

Enclosures

cc: Via Email

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CERTIFICATE OF SERVICE

I, Bari R. Nadworny, an associate at the law firm of Baker & Hostetler LLP located at 45 Rockefeller Plaza, New York, New York 10111, hereby certify that on the 14th day of August, 2019, I caused to be served a true copy of the Notice of Appearance of Andrew M. Grossman via electronic mail upon the following parties and other persons entitled to notice:

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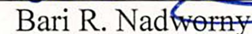

Bari R. Nadworny