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 REPLY MEMORANDUM IN SUPPORT OF HIS MOTION TO DISMISS THIS ADMINISTRATIVE PROCEEDING FOR CONSTITUTIONAL VIOLATIONS

Respondent David N. Pruitt ("Mr. Pruitt") respectfully files this Reply memorandum in further support of his Motion to Dismiss of August 14, 2019.

PRELIMINARY STATEMENT

This proceeding is barred by the Constitution twice over, and the Division's Opposition fails to demonstrate otherwise. So far as the Constitution's structural separation of powers is concerned, the Division does not dispute that Commission ALJs are subject to greater removal protections than those disapproved in *Free Enterprise Fund* and that effective concession should be the end of the matter. The Division's attempt to avoid that result rests on a foreclosed and untenable interpretation of just one of the three removal bars at issue and, even if it could be accepted, does not actually cure the constitutional defect because it would leave the other two bars in place. Likewise, the Division's claim that ALJs' "quasi-judicial" functions exempt them from ordinary separation-of-powers principles finds no support in the Constitution or case law and is at odds with the Supreme Court's recent exposition of the extensive authority exercised by Commission ALJs in *Lucia*. Straightforward application of *Free Enterprise Fund* and *Lucia* requires this proceeding to be dismissed.

So does the Seventh Amendment. The Division's argument that Mr. Pruitt is not entitled to a jury in this administrative proceeding begs the question of whether the Seventh Amendment permits a private-right action like this one to be brought in an administrative forum that does not permit jury trial. It does not: the exception that permits some matters to be decided in administrative forums without a jury is limited to "new statutory 'public rights.'" *Atlas Roofing Co. v. Occupational Safety & Health Comm'n*, 430 U.S. 442, 461 (1977). Courts have recognized that the statutory action for civil penalties here implicates private—not public—rights, and that conclusion is compelled by the Supreme Court's jurisprudence, which the

Division declined to address. The Division's apparent belief that that statutory action for civil penalties could implicate "private" rights when asserted in court but only "public" rights when asserted in an administrative proceeding is incompatible with the Supreme Court's statute-by-statute approach to determining whether a particular cause of action implicates public or private rights. And, in any instance, the Division does not dispute that the right at issue here is not a "new" one, which independently renders the administrative-proceeding exception to Seventh Amendment rights inapplicable.

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.

As an initial matter, the Division does not dispute that Commission ALJs are subject to removal protections that exceed those the Supreme Court held to be unconstitutionally excessive in *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010). *Free Enterprise Fund* rejected "*dual* for-cause limitations on the removal of [inferior officers] contravene the Constitution's separation of powers" because a double layer of insulation from removal "subverts the President's ability to ensure that the laws are faithfully executed—as well as the public's ability to pass judgment on his efforts." *Id.* at 492, 498 (emphasis added). Yet Commission ALJs are subject to *three* layers of insulation from removal: (1) members of the Commission are removable by the President only for good cause and are not "subject to the President's direct control," *id.* at 495; (2) the Commission may remove ALJs head "only for good cause established and determined by the Merit Systems Protection Board," 5 U.S.C. § 7521(a); and (3) Merit

Systems Protection Board members are removable by the President "only for inefficiency, neglect of duty, or malfeasance in office," 5 U.S.C. § 1202(d). No less than in *Free Enterprise Fund*, this structure disables the President from acting to "ensure that the laws are faithfully executed" and thereby 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." *Free Enter. Fund*, 561 U.S. at 496–97 (quotation marks omitted). It is unconstitutional.

Seeking to avoid that straightforward application of *Free Enterprise Fund*, the Division attempts to read one of the removal limitations out of the U.S. Code. *See* Division Br. at 2–4. It argues—citing no legal support, only an argument made in a Solicitor General brief[1]—that the "good cause" removal protection of 5 U.S.C. § 7521 should be interpreted to permit removal for failure to follow agency directives, which it claims would remedy the multiple-layers-of-removal-protection defect. This argument misses the mark, in several respects.

First, even on the assumption that Section 7521 can be so interpreted, Commission ALJs would still remain unconstitutionally subject to two levels of insulation from presidential control, because the members of both the SEC and Merit Systems Protection Board—whose concurrence would be necessary to effect a removal—also enjoy protection from removal. In other words, the Division's proffered interpretation, even if accepted, does not cure the constitutional defect.

Second, the Division's proffered interpretation is unavailable to the Commission. Courts have interpreted Section 7521's "good cause" standard to safeguard ALJs' "decisional independence," thereby precluding the Division's interpretation that they may be removed for

[1] An argument that, it should be noted, the Supreme Court did not accept. *See Lucia v. SEC*, 138 S. Ct. 2044, 2050 n.1 (2018).

mere failure to follow agency directives. *E.g., Brennan v. Dep't of Health & Human Servs.*, 787 F.2d 1559, 1562–63 (Fed. Cir. 1986) (stating rule and discussing authorities); *Berlin v. Dep't of Labor*, 772 F.3d 890, 894 (Fed. Cir. 2014); *Long v. Soc. Sec. Admin.*, 635 F.3d 526, 533 (Fed. Cir. 2011); *see also Butz v. Economou*, 438 U.S. 478, 513 (1978) ("[T]he process of agency adjudication is currently structured so as to assure that the hearing examiner exercises his independent judgment on the evidence before him, free from pressures by the parties or other officials within the agency."). Moreover, the Board itself has interpreted the "good cause" standard to preserve ALJs' "decisional independence," and courts have held that interpretation to be entitled to deference. *See Abrams v. Soc. Sec. Admin.*, 703 F.3d 538, 543 (Fed. Cir. 2012) (quoting interpretation and deferring to it). The Commission lacks the authority to override a sister agency's interpretation of a statute administered by that agency[2] and approved by the courts.

Third, and not least, the Division's proffered interpretation is wrong. In the decisions cited above, the Federal Circuit, which has exclusive jurisdiction over appeals from Board decisions, has held that the "APA does indeed have provisions to ensure the 'decisional independence' of ALJs and prohibits substantive reviews and supervision of an ALJ's quasi-judicial functions." *Long*, 635 F.3d at 535 (discussing, *inter alia*, *Brennan*, *supra*). Therefore, it has concluded, any interpretation of Section 7521's "good cause" standard that intrudes on ALJs' "decisional independence" would contravene the statute. *Id.* Yet that is precisely the interpretation urged by the Division, that an agency may remove ALJs whose decisions conflict

[2] Notably, "the Board has exclusive rulemaking and adjudicatory authority with respect to section 7521." *Long*, 635 F.3d at 534 (citing 5 U.S.C. §§ 1305, 7521; *Tunik v. Merit Sys. Prot. Bd.*, 407 F.3d 1326, 1336 (Fed. Cir. 2005)).

with "agency policies." Division Br. at 3. Because that interpretation would plainly permit agencies to intrude on ALJs' decisional independence, it is impermissible.

The Division fares no better with its argument that ALJs are somehow not exercising truly "executive" power and are therefore exempt from the separation-of-powers principles underlying *Free Enterprise Fund*. *See* Division Br. at 4–5. As the Supreme Court has recognized, although some of an agency's activities may take "'judicial' form[]," "they are exercises of—indeed, under our constitutional structure they *must be* exercises of—the 'executive Power.'" *City of Arlington, Tex. v. F.C.C.*, 569 U.S. 290, 304 n.4 (2013) (quoting U.S. Const., Art. II, § 1, cl. 1.). The Division's principal authority for its contrary argument is a Commission decision that principally rested its analysis on the ground that ALJs are mere "employees rather than inferior officers." *In the Matter of Optionsxpress, Inc. & Jonathan I. Feldman*, Release No. 10125 (Aug. 18, 2016). *Lucia*, of course, definitively rejected that position. 138 S. Ct. at 2054.

Lucia equally disposes of the Division's claim that the judicial or quasi-judicial nature of Commission ALJs' "functions" exempts them from the constitutional bar on multiple layers of removal protection. *Lucia* not only holds that Commission ALJs exercise "significant authority pursuant to the laws of the United States," *id.* at 2051 (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976)), but it also recognizes that they exercise substantial independent authority in their power to render decisions that can "become[] final" and be "deemed the action of the Commission" itself. *Id.* at 2053–54 (quotation marks omitted). Moreover, they "can respond to discovery violations and other contemptuous conduct by excluding the wrongdoer (whether party or lawyer) from the proceedings—a powerful disincentive to resist a court order." *Id.* at 2054.

They can suspend attorneys from proceedings altogether. *Id.* And they exercise "substantial informal power to ensure the parties stay in line." *Id.*[3]

All these powers are exercised in service of the faithful execution of law, which is ultimately the President's responsibility. Here, no different than in *Free Enterprise Fund*, "the President cannot remove an officer who enjoys more than one level of good-cause protection, even if the President determines that the officer is neglecting his duties or discharging them improperly. That judgment is instead committed to another officer, who may or may not agree with the President's determination, and whom the President cannot remove simply because that officer disagrees with him. This contravenes the President's constitutional obligation to ensure the faithful execution of the laws." 561 U.S. at 484. And it is therefore unconstitutional.[4]

II. THE ADMINISTRATIVE PROCEEDING VIOLATES MR. PRUITT'S SEVENTH AMENDMENT RIGHTS

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

The Division's insistence that the Seventh Amendment right to a jury trial "is not applicable to administrative proceedings" does not dispose of Mr. Pruitt's assertion of his Seventh Amendment rights. *See* Division Br. at 6 (quotation marks omitted). That argument responds only to the point that the Seventh Amendment entitles Mr. Pruitt to a jury trial in this administrative proceeding.[5] But, in asserting his jury right, Mr. Pruitt also argues that a civil penalty action like this one may not be brought in an administrative forum that deprives him of that right and that this action must therefore be dismissed. The Supreme Court's jurisprudence

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[3] The Division cites *Morrison v. Olson*, 487 U.S. 654 (1988), and *Wiener v. United States*, 357 U.S. 349 (1958), but neither addresses the constitutional infirmity at issue here, multiple layers of good-cause tenure protection.

[4] The Division does not dispute that, if Mr. Pruitt prevails on this issue, he is entitled to dismissal.

[5] To be clear, Mr. Pruitt preserves his challenge on this issue.

recognizes only that, "when Congress creates new statutory 'public rights,'" the Seventh Amendment does not bar it from "assign[ing] their adjudication to an administrative agency with which a jury trial would be incompatible." *Atlas Roofing Co. v. Occupational Safety & Health Comm'n*, 430 U.S. 442, 461 (1977). That exception from the Seventh Amendment's mandate does not reach this action because the right at issue here is neither a "public" one nor "new."

The Division's claim that the right at issue here is "public" ignores substantial precedent to the contrary. *SEC v. Lipson*, for example, holds that a party (like Mr. Pruitt) subject to a Commission action for civil penalties is entitled to a jury trial on liability, reflecting that such an action implicates private—not public—rights. 278 F.3d 656, 662 (7th Cir. 2002) (citing authorities). Indeed, the Division does not address the leading precedent in this area, *Tull v. United States*, which held that "[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." 481 U.S. 412, 423 (1987). There is no material difference between the Clean Water Act civil penalty at issue in *Tull* and the civil penalty at issue here, and the Division does not contend otherwise. The Division's broad argument (at 6–7) that any enforcement action "to protect the investing public" is exempt from the Seventh Amendment contravenes *Tull* and its progeny and is simply wrong. And the suggestion that a single statutory cause of action could be "public" in some instances and "private" in others—which is what the Division seems to be arguing—barely merits response. Suffice it to say, no court has analyzed the issue that way. Nor could one, because the focus of Seventh Amendment inquiry is on the substance of a given "statutory action." *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 42 (1989).

Finally, the Division does not dispute that the right at issue here is not "new." As Mr. Pruitt explained in his opening memorandum, when Congress authorized the Commission to

seek penalties through administrative adjudication, it did not create a new cause of action but allowed that preexisting ones could be asserted in administrative proceedings. As explained above, the preexisting action for civil penalties was indisputably subject to the Seventh Amendment jury right. And, for that reason, the Seventh Amendment precludes assigning its adjudication to administrative tribunals where a jury trial is not possible.

CONCLUSION

Mr. Pruitt respectfully requests that the Court dismiss these proceedings.

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