IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

TIMBERVEST, LLC, *et al.*,	:	
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	:	
Plaintiffs,	:	
	:	
v.	:	CIVIL ACTION NO.
	:	1:15-CV-2106-LMM
	:	
SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
	:	
Defendant.	:	

ORDER

This case comes before the Court on Plaintiffs Timbervest, LLC, Joel Barth Shapiro, Walter William Anthony Bolden, III, Donald David Zell, Jr., and Gordon Jones II's Motion for Temporary Restraining Order and Preliminary Injunction [3]. On June 12, 2015, Plaintiffs filed their Complaint, seeking to (1) declare the Securities and Exchange Commission's ("SEC") appointment and removal processes for its Administrative Law Judges ("ALJ") unconstitutional, and (2) enjoin the SEC from (a) publicly disseminating or publishing the SEC ALJ's initial decision in their proceeding or any future order which may be issued by the SEC, and (b) staying the effect of any relief entered against Plaintiffs in the administrative proceeding.[1] Compl., Dkt. No. [1]; Pls. Reply, Dkt. No. [22] at 7.

[1] For clarity, Plaintiffs do not seek to stay the entire administrative proceeding; they only seek to stay publication of the initial decision or any future final order

The Court heard oral argument on July 13, 2015. After a review of the record and due consideration, Plaintiffs' Motion [3] is **DENIED** for the following reasons:

I. Background[2]

Plaintiff Timbervest, LLC ("Timbervest") is a registered investment advisor that manages timberland and other environmental assets on behalf of various investment funds. Compl., Dkt. No. [1] ¶¶ 12-13. The remaining Plaintiffs are all officers in Timbervest: Joel Shapiro is the CEO, Walter Boden, III is the CIO, Donald Zell, Jr. is the COO, and Gordon Jones II is the President. Id. ¶¶ 14-17.

Timbervest manages three commingled timberland funds and three commingled environmental funds with approximately $1.2 billion in assets. Id. ¶ 21. In 2010, the SEC's Division of Enforcement began investigating Timbervest's policies and methods for valuing timberland properties. Id. ¶ 22.

On September 24, 2013, the SEC served Plaintiffs with an Order Instituting Cease-and-Desist Proceedings ("OIP"), which initiated the SEC's administrative enforcement action against Plaintiffs. Id. ¶ 23; OIP, Dkt. No. [3-3]. The SEC alleges Plaintiffs have violated Sections 206(1) and 206(2) of the Investment Advisors Act by (1) failing to disclose fees earned in the sale of two properties; and (2) selling one of the properties to a third party and later repurchasing the

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(not their issuance) and the SEC's ability to enforce its order against them pending resolution of constitutional issues.

[2] The following facts are drawn from the Complaint unless otherwise indicated, and any fact finding is made solely for the purposes of this Motion.

property through a different Timbervest fund. OIP, Dkt. No. [3-3] at 4; Compl., Dkt. No. [1] ¶ 23.

A. SEC Administrative Process

The Exchange Act authorizes the SEC to initiate enforcement actions against "any person" suspected of violating the Act and gives the SEC the sole discretion to decide whether to bring an enforcement action in federal court or an administrative proceeding. See, e.g., 15 U.S.C. §§ 78u(d), 78u-1, 78u-2, 78u-3. The Administrative Procedure Act ("APA"), 5 U.S.C. § 500, et seq., authorizes executive agencies, such as the SEC, to conduct administrative proceedings before an Administrative Law Judge ("ALJ"). SEC administrative proceedings vary greatly from federal court actions.

The SEC's Rules of Practice, 17 C.F.R. § 201.100, et seq., provide that the SEC "shall" preside over all administrative proceedings whether by the Commissioners handling the matter themselves or delegating the case to an ALJ; there is no right to a jury trial. 17 C.F.R. § 201.110. When an ALJ is selected by the SEC to preside—as was done by the SEC in Plaintiffs' case—the ALJ is selected by the Chief Administrative Law Judge. Id. The ALJ then presides over the matter (including the evidentiary hearing) and issues the initial decision. 17 C.F.R. § 201.360(a)(1). However, the SEC may on its own motion or at the request of a party order interlocutory review of any matter during the ALJ proceeding; "[p]etitions by parties for interlocutory review are disfavored," though. 17 C.F.R. § 201.400(a).

The initial decision can be appealed by either the respondent or the SEC's Division of Enforcement, 17 C.F.R. § 201.410, or the SEC can review the matter "on its own initiative." 17 C.F.R. § 201.411(c). A decision is not final until the SEC issues it. If there is no appeal and the SEC elects not to review an initial order, the ALJ's decision is "deemed the action of the Commission," 15 U.S.C. § 78d-1(c), and the SEC issues an order making the ALJ's initial order final. 17 C.F.R. § 201.360(d)(2).

If the SEC grants review of the ALJ's initial decision, its review is essentially *de novo* and it can permit the submission of additional evidence. 17 C.F.R. §§ 201.411(a), 201.452. However, the SEC will accept the ALJ's "credibility finding, absent overwhelming evidence to the contrary." In re Clawson, Exchange Act Release No. 48143, 2003 WL 21539920, at *2 (July 9, 2003); In re Pelosi, Securities Act Release No. 3805, 2014 WL 1247415, at *2 (Mar. 27, 2014) ("The Commission gives considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor. Such determinations can be overcome only where the record contains substantial evidence for doing so.") (footnote and internal quotation marks omitted).

If a majority of the participating Commissioners do not agree regarding the outcome, the ALJ's initial decision "shall be of no effect, and an order will be issued in accordance with this result." 17 C.F.R. § 201.411(f). Otherwise, the SEC will issue a final order at the conclusion of its review.

If respondents such as Plaintiffs lose with the SEC, they may petition for review of the SEC's order in the federal court of appeals (either their home circuit or the D.C. Circuit). E.g. 15 U.S.C. §§ 78y(a)(1), 80a-42(a), 80b-13(a). Once the record is filed, the court of appeals then retains "exclusive" jurisdiction "to affirm or modify and enforce or to set aside the order in whole or in part." 15 U.S.C. § 78y(a)(3). The SEC's findings of facts are "conclusive" "if supported by substantial evidence." 15 U.S.C. § 78y(a)(4). The court of appeals may also order additional evidence to be taken before the SEC and remand the action for the SEC to conduct an additional hearing with the new evidence. 15 U.S.C. § 78y(a)(5). The SEC then files its new findings of facts based on the additional evidence with the court of appeals which will be taken as conclusive if supported by substantial evidence. Id.

B. SEC ALJs

SEC ALJs, including ALJ Cameron Elliot who presides over Plaintiffs' case, are "not hired through a process involving the approval of the individual members of the Commission." SEC Aff., Dkt. No. [3-7] ¶ 4; see also 5 C.F.R. § 930.204 ("An agency may appoint an individual to an administrative law judge position only with prior approval of OPM, except when it makes its selection from the list of eligibles provided by OPM. An administrative law judge receives a career appointment and is exempt from the probationary period requirements under part 315 of this chapter."). An ALJ's salary is set by statute. 5 U.S.C. § 5372.

Congress has authorized the SEC to delegate its functions to an ALJ. E.g., 15 U.S.C. §§ 78d-1(a), 80b-12. Pursuant to that authority, the SEC has promulgated regulations, which set out its ALJ's powers. 17 C.F.R. § 200.14 makes ALJs responsible for the "fair and orderly conduct of [administrative] proceedings" and gives them the authority to: "(1) Administer oaths and affirmations; (2) Issue subpoenas; (3) Rule on offers of proof; (4) Examine witnesses; (5) Regulate the course of a hearing; (6) Hold pre-hearing conferences; (7) Rule upon motions; and (8) Unless waived by the parties, prepare an initial decision containing the conclusions as to the factual and legal issues presented, and issue an appropriate order." 17 C.F.R. § 200.14(a);[3] see also 17 C.F.R. § 200.30–9 (authorizing ALJs to make initial decisions).

[3] The SEC Rules of Practice provide a similar list of powers for "hearing officers," or ALJs. 17 C.F.R. § 201.101(a)(5) ("(5) Hearing officer means an administrative law judge, 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"). 17 C.F.R. § 201.111 provides,

> The hearing officer shall have the authority to do all things necessary and appropriate to discharge his or her duties. No provision of these Rules of Practice shall be construed to limit the powers of the hearing officer provided by the Administrative Procedure Act, 5 U.S.C. 556, 557. The powers of the hearing officer include, but are not limited to, the following:
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> (a) Administering oaths and affirmations;
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> (b) Issuing subpoenas authorized by law and revoking, quashing, or modifying any such subpoena;
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> (c) Receiving relevant evidence and ruling upon the admission of evidence and offers of proof;

The SEC's website also describes SEC ALJs in the following manner:

> (d) Regulating the course of a proceeding and the conduct of the parties and their counsel;
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> (e) Holding prehearing and other conferences as set forth in § 201.221 and requiring the attendance at any such conference of at least one representative of each party who has authority to negotiate concerning the resolution of issues in controversy;
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> (f) Recusing himself or herself upon motion made by a party or upon his or her own motion;
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> (g) Ordering, in his or her discretion, in a proceeding involving more than one respondent, that the interested division indicate, on the record, at least one day prior to the presentation of any evidence, each respondent against whom that evidence will be offered;
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> (h) Subject to any limitations set forth elsewhere in these Rules of Practice, considering and ruling upon all procedural and other motions, including a motion to correct a manifest error of fact in the initial decision. A motion to correct is properly filed under this Rule only if the basis for the motion is a patent misstatement of fact in the initial decision. Any motion to correct must be filed within ten days of the initial decision. A brief in opposition may be filed within five days of a motion to correct. The hearing officer shall have 20 days from the date of filing of any brief in opposition filed to rule on a motion to correct;
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> (i) Preparing an initial decision as provided in § 201.360;
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> (j) Upon notice to all parties, reopening any hearing prior to the filing of an initial decision therein, or, if no initial decision is to be filed, prior to the time fixed for the filing of final briefs with the Commission; and
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> (k) Informing the parties as to the availability of one or more alternative means of dispute resolution, and encouraging the use of such methods.

17 C.F.R. § 201.111.

> 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.
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> An Administrative Law Judge may order 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.

SEC Office of Administrative Law Judges, http://www.sec.gov/alj (last visited August 3, 2015).

C. Plaintiffs' Administrative Proceeding

As stated supra, the SEC filed an OIP against Plaintiffs on September 24, 2013. Compl., Dkt. No. [1] ¶ 22. The SEC originally ordered Chief Judge Brenda Murray to preside over Plaintiffs' hearing, but on December 16, 2013, Chief ALJ Murray designated ALJ Elliot to preside. Id. ¶ 25. The SEC held an eight-day hearing in front of ALJ Elliot. Id. ¶ 27. Plaintiffs claim that ALJ Elliot improperly ruled that (1) some exculpatory witness notes were not *Brady* material and did

not need to be produced, and (2) allowed the SEC's Enforcement Division to introduce irrelevant allegations. Id. ¶¶ 28-29. On August 20, 2014, ALJ Elliot ruled that Timbervest violated §§ 206(1) and (2) of the Investment Advisers Act and that the individual Plaintiffs acted with scienter in aiding, abetting, and causing those violations. Id. ¶¶ 30-31. Plaintiffs claim that the ALJ's decision turned heavily on several credibility determinations, all of which went against Plaintiffs. Id. ¶ 32. That initial order is currently available on the SEC's website.

On October 30, 2014, Timbervest appealed ALJ Elliot's decision to the SEC. In the appeal, Plaintiffs argued that the evidence did not support the ALJ's findings and that the SEC's administrative forum was unconstitutional. Id. ¶ 33. The SEC held oral argument on those issues on June 8, 2015. Id.

Prior to oral argument, the Wall Street Journal published an article entitled "SEC Wins With In-House Judges" in which a former SEC ALJ stated that she was pressured to rule in favor of the SEC and that Chief Judge Murray questioned her loyalty to the SEC because the former ALJ found in favor of defendants too often. Id. ¶ 34. The former ALJ also alleged that the SEC instructed her to work under the presumption that defendants were guilty until proven innocent. Id. Based on that article, Plaintiffs requested that the SEC produce evidence relevant to the former ALJ's allegations because those statements were relevant to Plaintiffs' due process, impartiality claim which was pending before the Commission. Id.

On May 11, 2015, Plaintiffs learned that SEC attorneys had admitted in a Southern District of New York case that the SEC did not appoint the ALJ in the underlying administrative proceeding for that matter. Id. ¶ 35. Plaintiffs then requested the SEC produce information as to how ALJs Murray and Elliot were appointed. Id.

On May 27, 2015, the SEC ordered that its staff produce an affidavit which addressed how ALJs Murray and Elliot were hired, including the method of selection or appointment. On June 4, 2015, the SEC staff produced an affidavit which stated ALJ Elliot was not appointed by the Commission but did not address Chief ALJ Murray. The staff did file a memo, however, which stated Chief Judge Murray began her work at the agency in 1988 and additional information regarding hiring practices at that time was not available. Id. ¶ 36.

The same day, the SEC found that Plaintiffs' motion would be assisted by obtaining additional evidence and requested that ALJ Elliot file an affidavit which addressed whether he had experienced any of the pressures or communications referenced in the Wall Street Journal article and/or any other experiences related to bias he had experienced. Id. ¶ 37. On June 10, 2015, Plaintiffs were advised that ALJ Elliot notified the SEC's Secretary that he would not submit an affidavit. Id.

On June 12, 2015, Plaintiffs filed the instant motion, asking this Court to (1) declare the SEC's appointment and removal processes for its ALJs unconstitutional, and (2) enjoin the SEC's publication of Plaintiffs' initial order,

any future SEC order, and any sanctions, if ordered. The Court heard oral argument on July 13, 2015. The SEC opposes Plaintiffs' Motion, arguing that (1) this Court does not have subject matter jurisdiction, and (2) even if it does, Plaintiffs have failed to meet their burden under the preliminary injunction standard.

II. Discussion[4]

A. Subject Matter Jurisdiction

The SEC first contends that this Court does not have subject matter jurisdiction because the administrative proceeding, with its eventual review from a court of appeals, has exclusive jurisdiction over Plaintiffs' constitutional claims. In other words, the SEC contends that its election to pursue claims against Plaintiffs in an administrative proceeding, "channels claims like Plaintiffs' through the Commission's administrative process and then directly to an

[4] On June 8, 2015, this Court issued a preliminary injunction in Hill v. SEC, No. 1:15-cv-1801-LMM, finding that (1) subject matter jurisdiction existed to address claims such as the Plaintiffs' here, and (2) the Hill plaintiff had demonstrated a likelihood of success on the merits that the SEC's ALJ appointment process violated the Appointments Clause. Much of the SEC's briefing, therefore, deals with the Court's prior holding in Hill. Accordingly, while many of the arguments are unchanged from Hill in this case, the Court will occasionally address the SEC's position in Hill to give context for the SEC's arguments and the Court's holding here.

The Court also notes that this hearing occurred immediately following another preliminary injunction hearing in Gray Financial Group, Inc. v. SEC, No. 1:15-cv-492-LMM. Because Plaintiffs' counsel had the benefit of hearing the Gray arguments and the SEC was represented by the same counsel at both arguments, some of the arguments made in Gray were discussed at the hearing and are also included here.

appropriate court of appeals that has 'exclusive' jurisdiction." Def. Br., Dkt. No. [18] at 20; see 15 U.S.C. §§ 80a-42(a), 80b-13(a); supra at 3-5 (explaining the administrative review procedure). The SEC thus argues that §§ 80b-42 and 80b-13 are now Plaintiffs' exclusive judicial review channels, and this Court cannot consider Plaintiffs' constitutional claims; judicial review can only come from the courts of appeal following the administrative proceeding and the SEC's issuance of a final order in Plaintiffs' case.

The SEC's position is in tension with 28 U.S.C. § 1331, which provides that federal district courts "have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States," and 28 U.S.C. § 2201, which authorizes declaratory judgments. "[I]t is established practice for [the Supreme] Court to sustain the jurisdiction of federal courts to issue injunctions to protect rights safeguarded by the Constitution." Bell v. Hood, 327 U.S. 678, 684 (1946); Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 491 n.2 (2010). And "injunctive relief has long been recognized as the proper means for preventing entities from acting unconstitutionally." Corr. Servs. Corp. v. Malesko, 534 U.S. 61, 74 (2001); see also 5 U.S.C. § 702 (stating that under the Administrative Procedure Act, any "person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof" and may seek injunctive relief).

To restrict the district court's statutory grant of jurisdiction under § 1331, there must be Congressional intent to do so. The Supreme Court has held that, "[p]rovisions for agency review do not restrict judicial review unless the 'statutory scheme' displays a 'fairly discernible' intent to limit jurisdiction, and the claims at issue 'are of the type Congress intended to be reviewed within th[e] statutory structure.'" Free Enterprise, 561 U.S. at 489 (quoting Thunder Basin Coal Co. v. Reich, 510 U.S. 200, 207, 212, 114 S.Ct. 771, 127 L.Ed.2d 29 (1994)).

The SEC contends that despite statutory language providing that these types of enforcement actions could be heard in *either* the district court *or* administrative proceedings, once the SEC selected the administrative forum, Plaintiffs were bound by that decision and §§ 80b-42 and 80b-13 became the exclusive judicial review provisions. The SEC argues that Congress declared its intent for the administrative proceeding to be the exclusive forum for judicial review for these cases by allowing the SEC to make the administrative proceeding its forum choice. See Def. Br., Dkt. No. [18] at 21-23 (citing Thunder Basin, 510 U.S. at 207-16).

The Court finds, however, that Congress's purposeful language allowing *both* district court and administrative proceedings shows a different intent. Instead, the clear language of the statute provides a choice of forum, and there is no language indicating that the administrative proceeding was to be an exclusive forum. There can be no "fairly discernible" Congressional intent to limit jurisdiction away from district courts when the text of the statute provides the

district court as a viable forum. In fact, the SEC admitted at the hearing that under the statutory scheme, it could choose to bring both an administrative proceeding and a district court action at the same time against the same person involving the same case. The SEC then argued that Congress intended to give the SEC the right to split the proceedings into two different forums but did not intend to give Plaintiffs that same right. The clear language of the statute does not support that interpretation.

The SEC cannot manufacture Congressional intent by making the forum choice for Congress; Congress must express its own intent within the language of the statute. In Free Enterprise, the Supreme Court held that the text of § 78y—a substantively identical provision, in relevant part, to the ones at issue here—"does not expressly limit the jurisdiction that other statutes confer on district courts. See, e.g., 28 U.S.C. §§ 1331, 2201. Nor does it do so implicitly." 561 U.S. at 489.

Here, the Court finds that because Congress created a statutory scheme which expressly included the district court as a permissible forum for the SEC's claims, Congress did not intend to limit § 1331 and prevent Plaintiffs from raising their collateral constitutional claims in the district court. Congress could not have intended the statutory review process to be exclusive because it expressly provided for district courts to adjudicate not only constitutional issues but Exchange Act violations, at the SEC's option. See Elgin v. Dep't of Treasury, __ U.S. __, 132 S. Ct. 2126, 2133 (2012) ("To determine whether it is 'fairly

discernible' that Congress precluded district court jurisdiction over petitioners' claims, we examine the [the Exchange Act]'s text, structure, and purpose.").

The Court also does not find that Thunder Basin prevents this finding. The SEC claims that the SEC's judicial review process is "virtually identical" to the Mine Act's, and thus this Court should find—as the Supreme Court did in Thunder Basin—that the SEC's judicial review scheme is "exclusive." Def. Br., Dkt. No. [18] at 21. Pretermitting the fact that the Mine Act did not create the forum selection provision which the SEC enjoys here, Thunder Basin was a challenge to the agency's interpretation of a statute it was charged with enforcing, as opposed to here, where Plaintiffs are challenging the validity of the administrative process itself. The nature of the claims at issue in Thunder Basin determined that the constitutional claims were required to go through that review scheme.[5] Because a materially different challenge exists in the instant case, the Court therefore does not find the SEC's administrative proceeding is exclusive pursuant to Thunder Basin.

[5] Notably, since Thunder Basin, other courts have held that the Mine Act does not preclude *all* constitutional claims from district court jurisdiction. See Elk Run Coal Co. v. U.S. Dep't of Labor, 804 F. Supp. 2d 8, 19 (D.D.C. 2011) (finding that the Mine Act did not preclude "broad constitutional challenges" from district court jurisdiction, and stating that Thunder Basin supported such a finding).

The Court accordingly finds that it has subject matter jurisdiction.[6] Therefore, the Court will now determine whether Plaintiffs are entitled to a preliminary injunction on their Article II claims.

B. Preliminary Injunction

To obtain a preliminary injunction, the moving party must demonstrate: (1) a substantial likelihood of success on the merits; (2) a substantial threat of irreparable injury if the injunction is not granted; (3) the threatened injury to the movant outweighs the damage to the opposing party; and (4) granting the injunction would not be adverse to the public interest. Four Seasons Hotels & Resorts, B.V. v. Consorcio Barr, S.A., 320 F.3d 1205, 1210 (11th Cir. 2003). "The preliminary injunction is an extraordinary and drastic remedy not to be granted unless the movant 'clearly carries the burden of persuasion' as to the four prerequisites." United States v. Jefferson Cnty., 720 F.2d 1511, 1519 (11th Cir.

[6] Alternatively, the Court also notes that jurisdiction may be appropriate under the Free Enterprise and Elgin test. See Free Enterprise, 561 U.S. at 489 (stating a court may "presume that Congress does not intend to limit jurisdiction" if (1) "a finding of preclusion could foreclose all meaningful judicial review"; (2) "if the suit is wholly collateral to a statute's review provisions"; and if (3) "the claims are outside the agency's expertise.") (quoting Thunder Basin, 510 U.S. at 212-213) (internal quotations omitted). However, unlike the prior decisions in Hill v. SEC, 1:15-cv-1801, and Gray Financial Group, Inc. v. SEC, 1:15-cv-492, Plaintiffs' claims are more likely subject to meaningful judicial review following the administrative scheme as the ALJ proceedings have already been completed and are currently before the SEC. However, because the Court has already found subject matter jurisdiction on an alternative ground, the Court declines to decide the issue at this time.

1983) (quoting Canal Auth. v. Callaway, 489 F.2d 567, 573 (5th Cir. 1974)). The same factors apply to a temporary restraining order. Ingram v. Ault, 50 F.3d 898, 900 (11th Cir. 1995). The Court will consider each factor in turn.

1. Likelihood of Success on the Merits

Plaintiffs bring two claims under Article II of the Constitution: (1) that the ALJ's appointment violates the Appointments Clause of Article II because he was not appointed by the President, a court of law, or a department head, and (2) the ALJ's two-layer tenure protection violates the Constitution's separation of powers, specifically the President's ability to exercise Executive power over his inferior officers. Both of Plaintiffs' arguments depend on this Court finding that the ALJ is an inferior officer who would trigger these constitutional protections. See U.S. Const. art. II § 2, cl. 2; Freytag v. Comm'r of Internal Revenue, 501 U.S. 868, 880 (1991); Free Enterprise, 561 U.S. at 484, 506. Therefore, the Court will consider this threshold issue first.

a. Inferior Officer

The issue of whether the SEC ALJ is an inferior officer or employee for purposes of the Appointments Clause depends on the authority he has in conducting administrative proceedings. The Appointments Clause of Article II of the Constitution provides:

> [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, § 2, cl. 2. The Appointments Clause thus creates two classes of officers: principal officers, who are selected by the President with the advice and consent of the Senate, and inferior officers, whom "Congress may allow to be appointed by the President alone, by the heads of departments, or by the Judiciary." Buckley v. Valeo, 424 U.S. 1, 132 (1976). The Appointments Clause applies to all agency officers including those whose functions are "predominately quasijudicial and quasilegislative" and regardless of whether the agency officers are "independent of the Executive in their day-to-day operations." Id. at 133 (quoting Humphrey's Executor v. United States, 295 U.S. 602, 625-26 (1935)).

"[A]ny appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States,' and must, therefore, be appointed in the manner prescribed by § 2, cl. 2, of [Article II]." Freytag, 501 U.S. at 881 (quoting Buckley, 424 U.S. at 126) (alteration in the original). By way of example, the Supreme "Court has held that district-court clerks, thousands of clerks within the Treasury and Interior Departments, an assistant surgeon, a cadet-engineer, election monitors, federal marshals, military judges, Article I [Tax Court special trial] judges, and the general counsel for the Transportation Department are inferior officers." Kent Barnett, Resolving the ALJ Quandary, 66 Vand. L. Rev. 797, 812 (2013) (citing Free Enterprise, 561 U.S. at 540 (Breyer, J., dissenting) (citing cases)).

Plaintiffs claim that SEC ALJs are inferior officers because they exercise "significant authority pursuant to the laws of the Unites States" while the SEC contends ALJs are "mere employees" based upon Congress's treatment of them and the fact that they cannot issue final orders, cannot grant "certain injunctive relief," and do not have contempt power,[7] *inter alia*. The Court finds that based upon the Supreme Court's holding in Freytag, SEC ALJs are inferior officers. See also Duka, 2015 WL 1943245, at *8 ("The Supreme Court's decision in Freytag v. Commissioner, 501 U.S. 868 (1991), which held that a Special Trial Judge of the Tax Court was an 'inferior officer' under Article II, would appear to support the conclusion that SEC ALJs are also inferior officers.").

In Freytag, the Supreme Court was asked to decide whether special trial judges ("STJ") in the Tax Court were inferior officers under Article II. 501 U.S. at 880. The Government argued, much as the SEC does here, that STJs do "no more than assist the Tax Court judge in taking the evidence and preparing the proposed findings and opinion," id., and they "lack authority to enter a final decision." Id. at 881; see also Def. Br., Dkt. No. [18] at 30-35 (arguing that SEC ALJs are not inferior officers because they cannot enter final orders and are

[7] ALJs can find individuals in contempt, but cannot order fines or imprisonment as a possible sanction. See 17 C.F.R. § 201.180 (noting an ALJ can punish "[c]ontemptuous conduct" by excluding someone from a hearing or preventing them from representing another during the proceeding); Def. Br., Dkt. No. [18] at 35 (stating "SEC ALJs' power to punish contemptuous conduct is limited and does not include any ability to impose fines or imprisonment.").

subject to the SEC's "plenary authority"). The Supreme Court rejected that argument, stating that the Government's argument

> ignores the significance of the duties and discretion that special trial judges possess. The office of special trial judge is "established by Law," Art. II, § 2, cl. 2, and the duties, salary, and means of appointment for that office are specified by statute. See Burnap v. United States, 252 U.S. 512, 516–517 (1920); United States v. Germaine, 99 U.S. 508, 511–512 (1879). These characteristics distinguish special trial judges from special masters, who are hired by Article III courts on a temporary, episodic basis, whose positions are not established by law, and whose duties and functions are not delineated in a statute. Furthermore, special trial judges perform more than ministerial tasks. They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. In the course of carrying out these important functions, the special trial judges exercise significant discretion.

Freytag, 501 U.S. at 881-82.

The Court finds that like the STJs in Freytag, SEC ALJs exercise "significant authority." The office of an SEC ALJ is established by law, and the "duties, salary, and means of appointment for that office are specified by statute." Id.; see supra (setting out the ALJ system, to include the establishment of ALJs and their duties, salary, and means of appointment). ALJs are permanent employees—unlike special masters—and they take testimony, conduct trial, rule on the admissibility of evidence, and can issue sanctions, up to and including excluding people (including attorneys) from hearings and entering default. 17 C.F.R. §§ 200.14 (powers); 201.180 (sanctions).

Relying on Landry v. Federal Deposit Insurance Corp., 204 F.3d 1125 (D.C. Cir. 2000), the SEC argues that unlike the STJs who were inferior officers in

Freytag, SEC ALJs do not have contempt power and cannot issue final orders,[8] as the STJs could in limited circumstances. In Landry, the D.C. Circuit considered whether FDIC ALJs were inferior officers. The D.C. Circuit found FDIC ALJs, like the STJs, were established by law; their duties, salary, and means of appointment were specified by statute; and they conduct trials, take testimony, rule on evidence admissibility, and enforce discovery compliance. 204 F.3d at 1133-34. And it recognized that Freytag found that those powers constituted the exercise of "significant discretion . . . a magic phrase under the Buckley test." Id. at 1134 (internal citation omitted).

Despite the similarities of the STJs and the FDIC ALJs, the Landry court applied Freytag to hold that whether the entity had the authority to render a final decision was a dispositive factor. According to the D.C. Circuit, Freytag "noted that [(1)] STJs have the authority to render the *final* decision of the Tax Court in declaratory judgment proceedings and in certain small-amount tax cases," and (2) the "Tax Court was required to defer to the STJ's factual and credibility findings unless they were clearly erroneous." Landry, 204 F.3d at 1133 (emphasis

[8] Plaintiffs argue that SEC ALJ's can issue final orders because if the respondent does not petition the SEC to review the ALJ's initial order and the SEC does not decide to review the matter on its own, the "ALJ's initial decision 'becomes the decision of the Commission *without further proceedings*." Def. Br., Dkt. No. [18] at 22 (quoting 5 U.S.C. § 557(b)) (alteration omitted) (emphasis in original). The SEC argues that the SEC retains plenary authority over ALJs and the regulations make clear that only when the SEC itself issues an order does the decision become final. Def. Br., Dkt. No. [18] at 15 (citing 17 C.F.R. § 201.360(d)). This Court agrees with the SEC. Because the regulations specify that the SEC itself must issue the final order essentially "confirming" the initial order, the Court finds that SEC ALJs do not have final order authority.

in original). While recognizing that the Freytag court "introduced mention of the STJ's power to render final decisions with something of a shrug," Landry held that FDIC ALJ's were not inferior officers because they did not have the "power of final decision in certain classes of cases." Id. at 1134.

The concurrence rejected the majority's reasoning, finding that Freytag "cannot be distinguished" because "[t]here are no relevant differences between the ALJ in this case and the [STJ] in Freytag." Id. at 1140, 1141. After first explaining that the Supreme Court actually found the Tax Court's deference to the STJ's credibility findings was irrelevant to its analysis,[9] the concurrence stated that the majority's "first distinction of Freytag is thus no distinction at all." Id. at 1142. The concurrence also noted that the majority's holding in Landry (which ultimately relied on the FDIC ALJ's lack of final order authority) was based on an *alternative* holding from Freytag as the Supreme Court had already determined the STJs were inferior officers before it analyzed the final order authority issue. Landry, 204 F.3d at 1142.

The Landry decision is also not persuasive as FDIC ALJs differ from SEC ALJs in that their decisions are purely recommendary under the APA. The APA requires agencies to decide whether their ALJs will issue "initial decisions" or "recommendary decisions." Initial decisions may become final "without further

[9] The Supreme Court stated that Tax Court Rule 183, which established the deferential standard, was "not relevant to [its] grant of certiorari," and noted that it would say no more about the rule than to say that the STJ did not have final authority to decide Petitioner's case. Freytag, 501 U.S. at 874 n.3; see also Landry, 204 F.3d at 1142 (Randolph, J., concurring).

proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule," while recommendary decisions always require further agency action. 5 U.S.C. § 557(b). FDIC ALJs issue recommendary decisions, whereas SEC ALJs issue initial decisions. On this ground alone, FDIC ALJs are different from SEC ALJs.

The Court concludes that the Supreme Court in Freytag found that the STJs powers—which are nearly identical to the SEC ALJs here—were independently sufficient to find that STJs were inferior officers. See also Butz v. Economou, 438 U.S. 478, 513 (1978) ("There can be little doubt that the role of the . . . administrative law judge . . . is ' functionally comparable' to that of a judge. His powers are often, if not generally, comparable to those of a trial judge: He may issue subpoenas, rule on proffers of evidence, regulate the course of the hearing, and make or recommend decisions."); see also Freytag, 501 U.S. at 910 (Scalia, J., concurring in part and concurring in judgment, joined by O'Connor, Kennedy, & Souter, JJ.) (finding that all ALJs are "executive officers"); Edmond v. United States, 520 U.S. 651, 663 (1997) ("[W]e think it evident that 'inferior officers' are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate."). Only after it concluded STJs were inferior officers did Freytag address the STJ's ability to issue a final order; the STJ's limited authority to issue final orders was only an additional reason, not *the* reason. Therefore, the

Court finds that Freytag mandates a finding that the SEC ALJs exercise "significant authority" and are thus inferior officers.

At the hearing, the SEC argued Freytag's finding that STJ's limited final order authority supported their inferior officer status was not an alternative holding but a "complimentary" one. The SEC also stated the Supreme Court's finding that the STJs had final order authority was the "most critical part" of the Freytag decision. The Court finds that understanding is based on a misreading of Freytag. First, the Supreme Court explicitly rejected the Government's argument in Freytag that "special trial judges may be deemed employees in subsection (b)(4) cases because they lack authority to enter a final decision." Freytag, 501 U.S. at 881. Second, the Supreme Court only discussed the STJs limited final order authority as being an *additional* reason for their inferior officer status. Id. at 882 ("*Even if* the duties of special trial judges under subsection (b)(4) were not as significant as we and the two courts have found them to be, our conclusion would be unchanged.") (emphasis added). It was only after the Supreme Court found STJs were inferior officers that it discussed their limited final order authority as being another ground for inferior officer status.

The Court also does not find persuasive the SEC's argument that SEC ALJs are not inferior officers because they cannot issue "certain injunctive relief" as could the Special Trial Judges in Freytag. Def. Br., Dkt. No. [18] at 33-34. It is undisputed that the *SEC Commissioners* themselves—who are indisputably

officers of the United States—cannot issue injunctive relief without going to the district court. Thus, the Court finds this a distinction without consequence.

The SEC also argues that this Court should defer to Congress's apparent determination that ALJs are inferior officers. In the SEC's view, Congress is presumed to know about the Appointments Clause, and it decided to have ALJs appointed through OPM and subject to the civil service system; thus, Congress intended for ALJs to be employees according to the SEC. See Def. Br. [18] at 35-39. But "[t]he Appointments Clause prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint." Freytag, 501 U.S. at 880. Even if the SEC is correct that Congress determined that ALJs are inferior officers, Congress may not "decide" an ALJ is an employee, but then give him the powers of an inferior officer; that would defeat the separation-of-powers protections the Clause was enacted to protect.

In response to the SEC's argument that classifying ALJs as civil servants informs their constitutional status, the Court notes that competitive civil service by its terms also includes officers within its auspices. "Competitive [civil] service" includes with limited exceptions "all civil service positions in the executive branch," 5 U.S.C. § 2102, and "officers" are specifically included within competitive service. 5 U.S.C. § 2104. Thus, under the SEC's reasoning, all officers are now mere employees by virtue of Congress's placement of them in civil service. Such an argument cannot be accepted.

As well, the SEC argues that "Congress envisioned an ALJ's 'initial decision' as 'advisory in nature'; it would merely 'sharpen[] . . . the issues for subsequent proceedings." Def. Br., Dkt. No. [18] at 31-32 (citing Attorney General's Manual on the Administrative Procedure Act ("Manual"), http://archive.law.fsu.edu/library/admin/1947vii.html, at 83-84 (1947)). But in reading the Manual, the Court finds the SEC has taken the Attorney General's statement out of context. With regard to ALJs "sharpening" "the issues for subsequent proceedings," the Attorney General was discussing cases in which the credibility of witnesses was not material or where the ALJ who drafted the opinion was not the hearing officer. Manual, at 83-84 ("However, in cases where the credibility of witnesses is not a material factor, or cases where the recommended or initial decision is made by an officer other than the one who heard the evidence, the function of such decision will be, rather, **the sharpening of the issues for subsequent proceedings**.") (emphasis added). The Manual also refers to ALJs as "subordinate officers" consistent with their status as inferior officers. Id. The Court finds the SEC's arguments unavailing; the SEC ALJs are inferior officers.

b. Appointments Clause Violation

Because SEC ALJs are inferior officers, the Court finds Plaintiffs have established a likelihood of success on the merits of their Appointments Clause claim. Inferior officers must be appointed by the President, department heads, or

courts of law. U.S. Const. art. II § 2, cl. 2. Otherwise, their appointment violates the Appointments Clause.

The SEC concedes that Plaintiffs' ALJ, ALJ Elliot, was not appointed by an SEC Commissioner. SEC Aff., Dkt. No. [3-7] ¶ 4; see also Free Enterprise, 561 U.S. at 511-512 (finding that the SEC Commissioners jointly constitute the "head" of the SEC for appointment purposes). The SEC ALJ was not appointed by the President, a department head, or the Judiciary. Because he was not appropriately appointed pursuant to Article II, his appointment is likely unconstitutional in violation of the Appointments Clause.[10]

4. Remaining Preliminary Injunction Factors

The Court finds that Plaintiffs have not satisfied the remaining preliminary injunction factors as Plaintiffs have failed to meet their burden that they will be irreparably harmed if this injunction does not issue. Plaintiffs seek limited relief: they request the Court enjoin the SEC's ability to publish its decisions or enforce those decisions against them until this matter is resolved; they do not seek to enjoin the proceeding or prevent the SEC from issuing its final order. However, unlike the procedural posture in the Court's prior decisions in Gray and Hill,

[10] Because the Court finds Plaintiffs can establish a likelihood of success on his Appointments Clause claim, the Court declines to decide at this time whether the ALJ's two-layer tenure protections also violate Article II's removal protections. However, the Court has serious doubts that it does, as ALJs likely occupy "quasi-judicial" or "adjudicatory" positions, and thus these two-layer protections likely do not interfere with the President's ability to perform his duties. See Duka, 2015 WL 1943245, at *8-10; see also Humphrey's Executor, 295 U.S. at 628-29, 631-32.

Plaintiffs waited until the ALJ had issued his initial decision and this case was before the SEC itself before filing this motion. Plaintiffs have already gone through the entirety of the administrative procedure before the ALJ—thus, no injunction will cure or prevent Plaintiffs' prior obligation to defend itself before the ALJ. And any harm which Plaintiffs have already suffered by virtue of the initial decision being published has already been experienced; removing the ALJ's initial decision from the website would not prevent a *future* harm.

Plaintiffs argue that by virtue of the initial decision being posted, they are subject to the results of an unconstitutional procedure. Pls. Rep., Dkt. No. [22] at 24-26. But even if the Court were to order the initial decision to be taken down, the initial decision has been publicly available since August 2014 and articles have been published about it. Reality dictates that the results of the initial decision will still be available in the public domain even if the decision is removed, albeit not in its most formal version.

Plaintiffs also argue that they may be subject to additional harm if the SEC publishes a final order or imposes additional future action against them while their appeal from the SEC's final order is pending. The Court finds that any future harm as to the judgment is speculative at this point as it has not yet been imposed. See Winter v. Natural Res. Def. Council, Inc., 555 U.S. 7, 22 (2008) (noting that plaintiffs must show "irreparable injury is *likely* in the absence of an injunction" and stating that "[i]ssuing a preliminary injunction based only on a possibility of irreparable harm is inconsistent with our characterization of

injunctive relief as an extraordinary remedy that may only be awarded upon a clear showing that the plaintiff is entitled to such relief.") (emphasis in original). And the SEC stated at the hearing that the SEC often stays its final orders pending appeal, so even if the SEC decides to impose future action against Plaintiffs, the SEC could agree to stay that harm (e.g., any bars, fines, or suspensions) pending appeal.[11] Therefore, the Court **DENIES** Plaintiffs' Motion [3].[12]

III. Conclusion

Plaintiffs' Motion for Temporary Restraining Order and Preliminary Injunction [3] is **DENIED**. The parties are **DIRECTED** to confer on a timetable for conducting discovery and briefing the remaining issues. The parties are then **DIRECTED** to submit by August 18, 2015, a consent scheduling order to the Court for consideration. If the parties are unable to agree to the terms of a scheduling order, the parties can submit their alternative submissions.

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[11] The Court notes, however, that if the SEC finds against Plaintiffs and refuses to stay its order notwithstanding the SEC's statements at the hearing, the Court would entertain a renewed motion for preliminary injunction following the final order.

[12] Because the Court finds Plaintiffs cannot demonstrate irreparable harm at this time, the Court declines to decide whether the remaining injunction factors are met. See Monsanto Co. v. Geertson Seed Farms, 561 U.S. 139, 156 (2010) ("[A] plaintiff seeking a permanent injunction must satisfy a four-factor test before a court may grant such relief.").

IT IS SO ORDERED this 4th day of August, 2015.

LEIGH MARTIN MAY
UNITED STATES DISTRICT JUDGE