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

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| GRAY FINANCIAL GROUP, INC., LAURENCE O. GRAY, and ROBERT C. HUBBARD, IV, | ) | |
| Plaintiffs, | ) | Civil Action File No. _____ |
| v. | ) | **COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF AND DEMAND FOR JURY TRIAL** |
| UNITED STATES SECURITIES AND EXCHANGE COMMISSION, | ) | |
| Defendant. | ) | |

Gray Financial Group, Inc. ("Gray Financial"), Laurence O. Gray ("Mr. Gray"), and Robert C. Hubbard, IV ("Mr. Hubbard") (collectively, "Plaintiffs") for their complaint against the United States Securities and Exchange Commission ("SEC" or the "Commission") allege as follows:

## Preliminary Statement

1. SEC administrative proceedings violate Article II of the U.S. Constitution, which states that the "executive Power shall be vested in a President of the United States of America."

2. An SEC Administrative Law Judge ("SEC ALJ") presides over an administrative proceeding. Federal statutes and SEC rules and regulations make clear that SEC ALJs are executive branch "officers" within the meaning of Article

II. The United States Supreme Court has held that such officers – charged with executing the laws, a power vested by the United States Constitution solely in the President – may not be separated from Presidential supervision and removal by more than one layer of tenure protection. *Free Enterprise Fund v. Pub. Co. Accounting Oversight Bd.,* 130 S. Ct. 3138, 561 U.S. 477 (2010) ("*Free Enterprise*"). In particular, if an officer can only be removed from office for good cause, then the decision to remove that officer cannot be vested in another official who, too, enjoys good-cause tenure. *Id*.

3. Yet SEC ALJs enjoy at least two – and likely more – layers of tenure protection. The SEC administrative proceedings therefore violate Article II and are unconstitutional.

4. The SEC has stated that it has made a preliminary determination to recommend that the Commission file an enforcement action alleging violations of federal securities laws against Gray Financial, Mr. Gray and Mr. Hubbard, and that said action will be in the form of an administrative proceeding and which may be filed imminently.

5. Declaratory and injunctive relief is necessary to prevent Gray Financial, Mr. Gray and Mr. Hubbard from being compelled to submit to an

unconstitutional proceeding and from suffering irreparable reputational and financial harm – all without meaningful judicial review.

**Jurisdiction, Venue, and Parties**

6. This Court has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331, 1337, 1346, 1651, 2201 and 5 U.S.C. §§ 702 and 706. Venue is proper in this district pursuant to 28 U.S.C. § 1391(b) and (e).

7. It is appropriate and necessary for this Court to exercise jurisdiction over Plaintiffs' claims because (a) without judicial review at this stage, meaningful judicial review will be foreclosed; (b) Plaintiffs' claims are wholly collateral to the review provisions of the federal securities laws; and (c) Plaintiffs' claims are not within the particular expertise of the SEC.

8. Gray Financial is a corporation organized and existing under the laws of the State of Georgia, having its principal place of business in Fulton County, Atlanta, Georgia, and does business under the names of Gray & Co, Gray & Company and GrayCo Global Advisors.

9. Laurence O. Gray is a natural person, citizen of the State of Georgia, and resident of Fulton County, Georgia, and resides in the Northern District of Georgia. Mr. Gray is the founder and principal of Gray Financial and its related entities.

10. Robert C. Hubbard is a natural person, citizen of the State of Georgia, and resident of Cobb County, Georgia, and resides in the Northern District of Georgia. Mr. Hubbard is the Co-Chief Executive Officer of Gray Financial.

11. The SEC is an agency of the United States government, headquartered in Washington, D.C. The SEC operates 11 regional offices, including one located at 950 East Paces Ferry Road, Atlanta, Georgia 30326.

## Background

12. Gray Financial is an investment advisory firm properly registered with the SEC and with the States of Georgia and Michigan. Gray Financial has remained a small, privately held registered investment advisor and has focused its business almost exclusively on consulting – primarily to public and private pension plans, many of which are Georgia plans. Gray is minority owned and appears to be one of the last – if not the last – remaining minority owned investment consulting firm serving public pension plans in any metropolitan city in the United States.

13. As an investment consultant, Gray Financial provides consulting services on a non-discretionary basis to both public and private entities with plan assets that at times have totaled nearly $10 billion. In that capacity, the services provided by Gray Financial may include assisting pension boards with the preparation, monitoring and annual review of investment policy guidelines,

conducting search, due diligence and presentations by investment money managers, and monitoring investment performance and providing a performance analysis.

**The New Georgia Pension Law (O.C.G.A. 47-20-87)**

14. On April 16, 2012, the Governor of Georgia signed into law the Public Retirement Systems Investment Authority Law (the "New Georgia Pension Law"), which for the first time allowed Georgia public pension plans – managing over $82 billion in cash and investment holdings[1] – the opportunity to diversify the risk of their multi-million dollar investment portfolios with "alternative investments."

15. Indeed, allocating a portion of portfolio funds to alternative investments – such as private equity, hedge funds and funds of funds – is recognized as an appropriate and important investment technique to reduce volatility and increase potential returns. Prior to passage of the New Georgia Pension Law, other states recognized the benefits of making alternative investments and had statutes authorizing their public pensions to make alternative investments.

[1] U.S. Census Bureau, 2013 Annual Survey of Public Pensions: State- and Locally-Administered Defined Benefit Pension Systems - All Data by State and Level of Government.

16. Although other state public pension laws may share the same underlying objectives as the New Georgia Pension Law to allow alternative investing, that is where the similarity ends. Those other states' pension laws are straightforward and are relatively reasonably clear in identifying the specific conduct that is authorized and that which is prohibited. In contrast, the New Georgia Pension Law, codified as O.C.G.A. 47-20-87, is unclear, vague and ambiguous. It uses unusual and, indeed, unique, language and undefined technical terms. Unlike other states' pension laws, it does not define clearly who must act, what must be done and when and how it must be done. Indeed, different but equally intelligent readers of the New Georgia Pension Law can and do arrive at reasonable but different interpretations of what specific conduct is and is not permitted by the statute.

17. There has not been any publicly available formal statutory interpretation of the unique language of the New Georgia Pension Law, either through reported legislative history or reported appellate case law. As a result, every reader of the New Georgia Pension Law – including the staff members of Gray Financial on one hand and the SEC – is left to his or her own devices to discern the intent of the statute because there is no guidance to be had.

**Assisted by Competent New York Based Legal Counsel, Gray Financial Successfully Develops Two Alternative Investment Fund of Funds**

18. For some time, Gray Financial had consulted with a number of its clients outside of Georgia about adding alternative investments as part of a diverse investment portfolio. To attempt to meet client demand for alternative investments, Gray Financial, through an affiliate, conceptualized an alternative investment fund-of-funds to be named GrayCo Alternative Partners I, LP ("Fund I"), which Gray Financial could offer to pension plans seeking access to alternative investments.

19. Neither Mr. Gray nor Mr. Hubbard have any formal legal training and typically would rely on legal professionals when needed. Accordingly, and before proceeding with the concept of Fund I, Gray Financial, through its affiliate, sought out and retained a well-regarded and experienced New York based law firm to handle all legal issues associated with the project and to assist with and advise on important business decisions. The project was successfully developed, clients outside of Georgia invested in Fund I, and those clients that remain have indicated that they have been pleased with their investment decision.

20. After the New Georgia Pension Law passed, Gray Financial considered offering to its Georgia pension plans a fund-of-funds alternative investment. Because its experience with Fund I had been successful, Gray

Financial, and its affiliate, turned to its New York based legal and business advisory team to create what would become known as GrayCo Alternative Partners II, LP ("Fund II"). Fund II would be largely based on the same structure that its New York-based counsel created for Fund I. Accordingly, Gray Financial, through its affiliate, retained the same New York based legal counsel for Fund II to evaluate all related legal issues impacting the project, including compliance with the New Georgia Pension Law. As with Fund I, the project was successfully developed, Georgia-based clients invested in Fund II and did so with no reported client losses.

**The SEC Begins an Onerous Investigation into the Marketing of Fund II to Georgia Pension Plans**

21. Although there had been no indication of any client losses in Fund I or Fund II, the SEC – a federal agency which is responsible for enforcing the federal securities laws – advised Gray Financial formally in August 2013 that it was conducting a confidential and non-public investigation into Gray Financial, Mr. Gray and Mr. Hubbard and whether Fund II complied with the New Georgia Pension Law. This investigation was against the backdrop that there had never previously been any allegations by any securities industry regulator – let alone proof – of any prior wrongdoing by Gray Financial, Mr. Gray or Mr. Hubbard or that any of them had violated any securities laws. Nevertheless, in providing

notice that its investigation had begun, the SEC stressed that severe penalties could be imposed if it was not afforded complete cooperation from those involved.

22. Although the SEC told Gray Financial that its investigation was "private," somehow the fact the SEC was investigating and the nature of that investigation were released to the local and national press, and in a significant way. It appeared that guilt was presumed, although the SEC had not issued formal charges, let alone proven in an unbiased forum that Gray Financial, Mr. Gray or Mr. Hubbard had engaged in any wrongdoing. The adverse impact to an investment advisor when a "private" investigation becomes a public one is predictable; but it is all-the-more substantial when the investment advisor is a small and locally owned one. The consequences of this became a harsh reality for Gray Financial and all of the employees of the firm. Once the investigation became public, Gray Financial had numerous consulting clients terminate their business relationships, RFPs for new business opportunities vanished, and revenues declined.

23. On August 1, 2014, the SEC issued Wells notices indicating that it had reached a preliminary conclusion that Gray Financial, Mr. Gray and Mr. Hubbard had violated certain specific federal securities laws. The SEC's primary theory of liability was – and indeed still is – that Gray Financial, Mr. Gray and Mr.

Hubbard had violated the Investment Advisers Act, sections 206(1), 206(2), and 206(4), and Rules 206(4)-8(a)(1) and (2) thereunder, by offering for sale to Georgia-based clients, an alternative investment fund that the SEC alleges is not in compliance with its interpretation of the New Georgia Pension Law. The SEC has even gone so far as to argue that the violations must have been intentional – not merely negligent – in order to seek more aggressive sanctions that the SEC can muster. This practice was not new or unique in this case.

24. On August 29, 2014, Gray Financial, Mr. Gray and Mr. Hubbard each provided written submissions in response to the SEC's Wells notices. In their responses, each demonstrated that a reasonable interpretation of the New Georgia Pension Law permits Georgia public pension plans to invest in Fund II. Moreover, to the extent there was a misinterpretation of the New Georgia Pension Law, it was as a result of the many ambiguities and defects in an unclear law and not the result of a willful or reckless disregard of the statute's requirements. To the contrary, Gray Financial, Mr. Gray and Mr. Hubbard relied on highly compensated and, what it reasonably believed to be, skilled counsel. They therefore had every reason to believe that the Fund II offering prepared by counsel complied with the New Georgia Pension Law. Finally, faced with a matter of first impression on the interpretation of a unique state statute that is at best unclear, the SEC should

reserve judgment for the Georgia legal system that should be in a better position to interpret a Georgia law.

**The SEC's Chosen Forum and Sanction**

25. The securities laws provide the SEC with the discretion – guided by no statute, regulation, or established practice – to bring an enforcement action either in federal district court or in internal SEC administrative proceedings.

26. The SEC staff has indicated to counsel for Gray Financial, Mr. Gray and Mr. Hubbard that the only action they can take to avoid charges being brought by the SEC is for them to agree to draconian settlement terms that would inflict a significant risk of financial, professional, and reputational harm to them, and, derivatively, the investors in Funds I and II, which includes Georgia public pensions.

27. The SEC staff has also informed counsel that the SEC would bring its enforcement action as promptly as possible, and would do so in an SEC administrative proceeding, rather than in federal district court. Based on these representations by the SEC staff, Gray Financial, Mr. Gray and Mr. Hubbard believe that the commencement of the enforcement action can occur at any time and the threat is imminent.

## The Administrative Proceeding

28. An administrative proceeding is an internal SEC hearing, governed by the SEC's Rules of Practice ("Rules of Practice," or "RoP") and litigated by SEC trial attorneys.

29. Administrative proceedings differ in several critical ways from federal court proceedings. Those differences make administrative proceedings more advantageous to the SEC, which include:

a. In administrative proceedings, an SEC ALJ serves as finder of both fact and of law.

b. Administrative proceedings do not afford juries to litigants, unlike federal court.

c. The Federal Rules of Civil Procedure do not apply in an administrative proceeding; they do apply in federal court.

d. The Federal Rules of Evidence, together with their associated protections, do not apply in an administrative proceeding; they do apply in federal court. Any evidence that "can conceivably throw any light upon the controversy," including unreliable hearsay testimony, "normally" will be admitted in an administrative proceeding. *In the Matter of Jay Alan*

*Ochanpaugh,* Securities Exchange Act Rel. No. 54363, 2006 SEC LEXIS 1926, *23 n.29 (Aug. 25, 2006).

e. Defendants' ability to conduct discovery is limited in administrative proceedings. For example, pre-trial depositions are generally not allowed in administrative proceedings; they are allowed in federal court. RoP 233, 234.

f. The SEC Rules of Practice do not provide respondents the opportunity to challenge the SEC's legal theories before trial dispositive motions; dispositive motions are available in federal court.

g. The SEC Rules of Practice do not allow respondents to assert counterclaims against the SEC. Federal court defendants may assert counterclaims against their adversaries.

h. The SEC Rules of Practice require the hearing to take place, at most, approximately four months from the issuance of the SEC's Order Instituting Proceedings ("OIP"). In its discretion, the SEC can require the hearing to occur as early as one month after the OIP is issued. While the SEC can allow itself years of investigation and research to prepare an administrative case, the SEC does not need to start making available the

limited discovery afforded to administrative proceeding respondents until seven days after the OIP is issued.

i. Administrative proceedings are private, closed to the public and the news media, unlike federal court proceedings. Nevertheless, the SEC uses the press affirmatively by issuing press releases to broadcast the fact it is bringing administrative cases.

36. Not surprisingly, the SEC has succeeded much more often in administrative proceedings, where it enjoys the procedural advantages described above, than in federal district courts, according to several observers. In fact, one recent study found that the SEC has won the last 219 decisions before its ALJs – a "winning streak, which began in October 2013 and continues today" – at a time when it has lost several high-profile decisions in the federal courts. Jenna Greene, *The SEC's on a Long Winning Streak*, National Law Journal, Jan. 22, 2015; Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES, Oct. 5, 2013; and others. The SEC's apparently unstoppable series of "wins" in administrative proceedings brings to mind long-ago discredited systems like monarchical Star Chambers and hard-line regimes' show trials. In contrast, when forced to bring cases before unbiased United States District Court Judges, on the level playing field of federal court where defendants are protected by juries, broad

discovery rights, robust rules of evidence, and other procedural safeguards, the SEC's win-loss record is far less pristine. In fact, in some cases, the federal courts have been openly critical of the SEC in the cases it selects to bring and how it brings them. One U.S. District Judge, noting that the SEC won 61% of its federal court trials versus 100% of its administrative proceedings, said that the courts have "functioned very effectively for decades," adding that he saw "no good reason to displace that constitutional alternative with administrative fiat." Nate Raymond, *U.S. Judge Criticizes SEC Use of In-house Court for Fraud Cases*, Reuters, Nov. 5, 2014.

37. Moreover, any appeal of an SEC ALJ's decision is heard by the SEC itself, the very body which, prior to the administrative proceeding, originally authorized the bringing of an administrative proceeding. Further, the SEC is empowered to decline to hear the appeal, or to impose even greater sanctions. A final order of the Commission, after becoming effective, would then need to be appealed to a United States Court of Appeals.

**SEC ALJs**

38. SEC ALJs, who preside over administrative proceedings, exercise authority and discretion that makes them officers for the purposes of Article II of the U.S. Constitution.

***Broad Discretion to Exercise Significant Power***

39. SEC ALJs enjoy broad discretion to exercise significant authority with respect to administrative proceedings. Under the SEC Rules of Practice, an SEC ALJ – referred to in the Rules of Practice as the "hearing officer" – is empowered, within his or her discretion, to perform the following, among other things:

a. Take testimony. RoP 111.

b. Conduct trials. *Id.*

c. Rule on admissibility of evidence. RoP 320.

d. Order production of evidence. RoP 230(a)(2), 232.

e. Issue orders, including show-cause orders. *See, e.g.*, 17 CFR 201.141(b); *In the Matter of China Everhealth Corp.*, Admin. Proc. Rel. No. 1639, 2014 SEC LEXIS 2601 (July 22, 2014).

f. Rule on requests and motions, including pre-trial motions for summary disposition. *See, e.g.*, RoP 250(b).

g. Grant extensions of time. RoP 161.

h. Dismiss for failure to meet deadlines. RoP 155(a).

i. Reconsider their own or other SEC ALJs' decisions. RoP 111(h).

j. Reopen any hearing prior to the filing of a decision. RoP 111(j).

k. Amend the SEC's OIP. RoP 200(d)(2).

l. Impose sanctions on parties for contemptuous conduct. RoP 180(a).

m. Reject filings that do not comply with the SEC's Rules of Practice. RoP 180(b).

n. Dismiss the case, decide a particular matter against a party, or prohibit introduction of evidence when a person fails to make a required filing or cure a deficient filing. RoP 180(c).

o. Enter orders of default, and rule on motions to set aside default. RoP 155.

p. Consolidate proceedings. RoP 201(a).

q. Grant law enforcement agencies of the federal or state government leave to participate. RoP 210(c)(3).

r. Regulate appearance of amici. RoP 210(d).

s. Require amended answers to amended OIPs. RoP 220(b).

t. Direct that answers to OIPs need not specifically admit or deny, or claim insufficient information to respond to, each allegation in the OIP. RoP 220(c).

u. Require the SEC to file a more definite statement of specified matters of fact or law to be considered or determined. RoP 220(d).

v. Grant or deny leave to amend an answer. RoP 220(e).

w. Direct the parties to meet for prehearing conferences, and preside over such conferences as the ALJ "deems appropriate." RoP 221(b).

x. Order any party to furnish prehearing submissions. RoP 222(a).

y. Issue subpoenas. RoP 232.

z. Rule on applications to quash or modify subpoenas. RoP 232(e).

aa. Order depositions, and act as the "deposition officer." RoP 233, 234.

bb. Regulate the SEC's use of investigatory subpoenas after the institution of proceedings. RoP 230(g).

cc. Modify the Rules of Practice with regard to the SEC's document production obligations. RoP 230(a)(1).

dd. Require the SEC to produce documents it has withheld. RoP 230(c).

ee. Disqualify himself or herself from considering a particular matter. RoP 112(a).

ff. Order that scandalous or impertinent matter be stricken from any brief or pleading. RoP 152(f).

gg. Order that hearings be stayed while a motion is pending. RoP 154(a).

hh. Stay proceedings pending Commission consideration of offers of settlement. RoP 161(c)(2).

ii. Modify the Rules of Practice as to participation of parties and amici. RoP 210(f).

jj. Allow the use of prior sworn statements for any reason, and limit or expand the parties' intended use of the same. RoP 235(a), (a)(5).

kk. Express views on offers of settlement. RoP 240(c)(2).

ll. Grant or deny leave to move for summary disposition. RoP 250(a).

mm. Order that hearings not be recorded or transcribed. RoP 302(a).

nn. Grant or deny the parties' proposed corrections to hearing transcript. RoP 302(c).

oo. Issue protective orders governing confidentiality of documents. RoP 322.

pp. Take "official notice" of facts not appearing in the record. RoP 323.

qq. Regulate the scope of cross-examination. RoP 326.

rr. Certify issues for interlocutory review, and determine whether proceedings should be stayed during pendency of review. RoP 400(c), (d).

***The SEC ALJ's Decision***

40. At the close of an administrative proceeding, the SEC ALJ issues his or her decision, referred to in the Rules of Practice as the "initial decision." RoP 360. The initial decision states in the time period within which a petition for Commission review of the initial decision may be filed. The SEC ALJ exercises his or her discretion to decide that time period.

41. The initial decision becomes the final decision of the SEC after the period to petition for review expires, unless the Commission takes the petition for review. With certain exceptions that do not apply in this matter, the Commission is not required to take up any SEC ALJ's decision for review.

42. As applied to this matter, Commission review is entirely discretionary. The Commission can deny a petition for review for any reason, after

considering whether the petition for review makes a reasonable showing that: (i) the decision embodies a clearly erroneous finding of material fact, an erroneous conclusion of law, or an exercise of discretion or decision of law or policy that is "important"; or (ii) a prejudicial error was committed during the proceeding.

43. If no party requests review, and if the Commission does not undertake review on its own initiative, no Commission review occurs. Instead, the Commission enters an order that the decision has become final, and "the action of [the] administrative law judge … shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 15 U.S.C. § 78d-1(c). The order of finality states the date on which sanctions imposed by the SEC ALJ, if any, will become effective. RoP 360(d)(2).

44. Nothing in the rules or statutes prevents the Commission from making the ALJ's sanction effective before the respondent has had an opportunity to appeal the Commission's order, and in fact the Commission routinely makes sanctions effective immediately. *See, e.g., In the Matter of Mark Andrew Singer,* Exchange Act. Rel. No. 72996, 2014 SEC LEXIS 3139 (Sept. 4, 2014).

***The Position of SEC ALJ***

45. The SEC is a "Department" of the Executive Branch of the U.S. Government. The individual Commissioners are the "heads" of the Department. *Free Enterprise*, 130 S. Ct. at 3163. The Commissioners appoint SEC ALJs.

46. The ALJ position is established by statute, which provides that each agency "shall" appoint as many ALJs as necessary for the agency's administrative proceedings. 5 U.S.C. § 3105.

47. The Administrative Procedure Act ("APA"), 5 U.S.C. § 500 *et seq.*, establishes ALJs' powers with respect to adjudication. 5 U.S.C. 556, 557. The securities laws empower the SEC to delegate certain functions to SEC ALJs, including those listed above at paragraphs 39.a through 39.rr and 40 through 43. 15 U.S.C. § 78d-1.

48. SEC regulation establishes the "Office of Administrative Law Judges," and outlines their authority. *See, e.g.,* 17 C.F.R. § 200.14; 17 C.F.R. § 200.30-9; 17 C.F.R. § 201.111. Those regulations provide that SEC ALJs' authority with respect to adjudications is to be as broad as the APA allows. 17 C.F.R. § 201.111 ("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.").

49. The salary of SEC ALJs is specified by statute. There are eight levels of basic pay for ALJs, the lowest of which may not be less than 65% of the rate of basic pay for level IV of the Executive Schedule, and the highest of which may not be more than the rate of basic pay for level IV of the Executive Schedule. 5 U.S.C. § 5372. (The Executive Schedule is a system of salaries given to the highest-ranked appointed positions in the executive branch of the U.S. government. 5 U.S.C. § 5311.)

50. The means of appointing an ALJ is specified by statute. Appointments are made by agencies based on need. 5 U.S.C. § 3105. By regulation, ALJs may be appointed only from a list of eligible candidates provided by the Office of Personnel Management ("OPM") or with prior approval of OPM. 5 C.F.R. § 930.204. OPM selects eligible candidates based on a competitive exam, which OPM develops and administers. The SEC, like other agencies, selects ALJs from OPM's list of eligible candidates, based on the SEC's need. 5 U.S.C. § 3105; 5 C.F.R. § 930.204.

51. All ALJs receive career appointments and are exempt from probationary periods that apply to certain other government employees. 5 C.F.R. § 930.204(a). They do not serve time-limited terms.

52. SEC ALJs are "officers" of the United States due, among other things, to the significant authority they exercise; the broad discretion they are afforded; their career appointments; that they are appointed by the heads of an Executive Department; the statutory and regulatory requirements governing their duties, appointment, and salary; the statutory authority creating their position; and their power, in certain instances, to issue the final decision of the agency.

***Removal of SEC ALJs***

53. SEC ALJs are removable from their position by the SEC "only" for "good cause," which must be "established and determined" by the Merit Systems Protection Board (MSPB"). 5 U.S.C. § 7521(a).

54. This removal procedure involves two or more levels of tenure protection.

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

56. Second, the SEC Commissioners, who exercise the power of removal, 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 Enterprise*, 130 S. Ct. at 3148; *MFS Sec. Corp. v. SEC*, 380 F.3d 611, 619-20 (2d Cir. 2004).

57. Third, members of the MSPB, who determine whether sufficient "good cause" exists to remove an SEC ALJ, are also protected by tenure. They are removable by the President "only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d).

**The SEC ALJs' Removal Scheme Violates Article II's Vesting of Executive Power in the President**

58. As executive officers, SEC ALJs may not be protected by more than one layer of tenure.

59. Article II of the U.S. Constitution vests "[t]he executive Power … in a President of the United States of America," who must "take care that the Laws be faithfully executed." U.S. Const. art. II, § 1, cl. 1; id., § 3. In light of "[t]he impossibility that one man should be able to perform all the great business of the State," the Constitution provides for executive officers to "assist the supreme Magistrate in discharging the duties of his trust." 30 Writings of George Washington 334 (J. Fitzpatrick ed. 1939); *see also Free Enterprise*, 561 U.S. 477, 130 S. Ct. at 3146.

60. 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 accountability. Specifically, as the Supreme Court held in *Free Enterprise*, Article II requires that executive

officers, who exercise significant executive power, not be protected from being removed by their superiors at will, when those superiors are themselves protected from being removed by the President at will.

61. The SEC ALJs' removal scheme is contrary to this constitutional requirement because SEC ALJs are inferior officers for the purposes of Article II, Section 2 of the U.S. Constitution, and because:

a. SEC ALJs are protected from removal by a statutory "good cause" standard; and

b. The SEC Commissioners who are empowered to seek removal of SEC ALJs – within the constraints of the "good cause" standard – are themselves protected from removal by an "inefficiency, neglect of duty, or malfeasance in office" standard; and

c. The MSPB members who are empowered to effectuate the removal decision – again limited by a "good cause" standard – are themselves protected from removal by an "inefficiency, neglect of duty, or malfeasance in office" standard.

62. Under this attenuated removal scheme, "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.'" *Free Enterprise*, 130 S. Ct. at 3147 (quoting *Morrison v. Olson*, 487 U.S. 654, 693 (1988)).

63. Because the President cannot oversee SEC ALJs in accordance with Article II, SEC administrative proceedings violate the Constitution.

**The SEC's Chosen Course Will Cause Plaintiffs Severe and Irreparable Harm**

64. Without injunctive relief from this Court, Plaintiffs will be required to submit to an unconstitutional proceeding. This violation of a constitutional right, standing alone, constitutes an irreparable injury. The lack of traditional procedural safeguards in SEC administrative proceedings further exacerbates that harm.

65. Allowing the SEC to pursue an administrative proceeding while the instant complaint is pending would require the expenditure of substantial legal fees defending against an unconstitutional action. Moreover, plaintiffs cannot assert counterclaims or seek declaratory relief in an administrative proceeding, foreclosing any possibility of review until an appeal to a federal circuit court of appeals. The burdens incurred during an administrative proceeding would be for naught, because such administrative proceeding is unconstitutional and the SEC likely would try to reprise its case in a lawful setting, such as federal district court.

However, forcing Plaintiffs to litigate twice would compound costs, lost time, and reputational risk.

66. Furthermore, if Plaintiffs were to lose in an administrative proceeding, the damage could be severe and irreversible, well before Plaintiffs could obtain meaningful judicial review of the Article II claim.

67. This severe harm, which threatens to damage Plaintiffs' business and potentially those investors in Fund II, is irreparable. The availability of an appeal after an administrative proceeding to a federal circuit court of appeals cannot avoid it, because the administratively-imposed sanction already may take effect – and the damage therefore already substantially and harmfully done – by the time the appellate court made a ruling.

68. Likewise, the harm cannot be remedied after the fact by money damages. Various immunity doctrines substantially constrain Plaintiffs' ability to seek damages from the SEC. Furthermore, even if damages were procedurally available, the reputational harm to Plaintiffs – possibly permanent and devastating to Plaintiffs' trust-based investment business – should the SEC impose administrative sanctions would be impossible to monetize.

69. By contrast, the SEC will suffer relatively little to no harm from a pause in an administrative proceeding against Plaintiffs pending final resolution of

this important constitutional issue. Any claim of harm by the SEC would be particularly fanciful because the SEC maintains the option of bringing its enforcement action against Plaintiffs in federal court, as it routinely does with other investment advisers. Moreover, the loans that were the subject of the SEC's investigation caused no pecuniary harm to investors. The fact that all of the loans have been fully repaid underscores further that there is no risk of current or future harm. Therefore, no investor would be adversely affected by injunctive relief from this Court.

**COUNT ONE**

**APPLICATION FOR INJUNCTIVE RELIEF**

70. Plaintiffs repeat and re-allege paragraphs 1 – 69 as if fully set forth in full.

71. Plaintiffs' constitutional rights will be irreparably harmed if a permanent injunction (and, if necessary, a preliminary injunction and temporary restraining order) are not issued against the SEC's administrative proceeding. Plaintiffs have a substantial likelihood of success on the merits of their claim. Plaintiffs will be irreparably injured without injunctive relief, as described above, and the harm to Plaintiffs, absent injunctive relief, far outweighs any harm to the

SEC if they are granted. Finally, the grant of an injunction will serve the public interest in the protection of parties' constitutional rights.

**COUNT TWO**

**DECLARATORY JUDGMENT**

72. Plaintiffs repeat and re-allege paragraphs 1 – 71 as if set forth in full.

73. Plaintiffs request a declaratory judgment that the statutory and regulatory provisions providing for the positions and tenure protections of SEC ALJs are unconstitutional.

**Jury Demand**

74. Plaintiffs hereby demand a trial by jury on all issues so triable.

WHEREFORE, Plaintiffs pray for judgment and relief as follows:

A. An order and judgment declaring unconstitutional the statutory and regulatory provisions providing for the position of an SEC ALJ and the tenure protections for that position.

B. An order and judgment enjoining the Commission from carrying out an administrative proceeding against Plaintiffs.

C. Such other and further relief as this Court may deem just and proper, including reasonable attorneys' fees and the costs of this action.

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Atlanta, GA

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