

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

TIMBERVEST, LLC; JOEL BARTH  
SHAPIRO; WALTER WILLIAM  
ANTHONY BODEN, III; DONALD  
DAVID ZELL, JR., and GORDON  
JONES II,

Plaintiffs,

v.

SECURITIES AND EXCHANGE  
COMMISSION,

Defendant.

Civil Action File  
No. \_\_\_\_\_

**COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF**

Plaintiffs submit their Complaint against the United States Securities and Exchange Commission (“SEC” or the “Commission”) 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 inferior “officers” within the meaning of Article II.

3. Article II, Section 2 of the United States Constitution vests the sole power to appoint inferior officers in the President, the courts, and the “heads of departments.” But SEC ALJs are not appointed by the President, the Courts, or the SEC Commissioners, making their exercise of power unconstitutional.

4. Further, the United States Supreme Court has held that inferior officers 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 be removed from office only for good cause, then the decision to remove that officer cannot be vested in another official who also enjoys good-cause tenure. *Id.*

5. 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.

6. The SEC has instituted an enforcement action alleging violations of federal securities laws against the Plaintiffs in the form of an administrative proceeding. Plaintiffs were forced to endure a hearing before ALJ Cameron Elliot, who has a perfect record before the Commission and who unsurprisingly issued an Initial Decision finding against Plaintiffs.

7. The ALJ’s decision turned heavily on credibility determinations that cannot be meaningfully reviewed by the SEC. The SEC accepts credibility

determinations by an ALJ unless there is “overwhelming evidence to the contrary.” *Clawson*, 2003 WL 21539920, at \*2 (July 9, 2003).

8. Plaintiffs have appealed the ALJ’s Initial Decision to the Commission, but it has become clear that the Commission should not hear these arguments. First, the Commission itself did not properly appoint the ALJ. Second, the Commission has argued in other cases that its administrative forum is constitutional. Thus, Plaintiffs’ appeal to the Commission is nothing more than an exercise in futility.

9. Declaratory and injunctive relief is necessary to prevent the irreparable harm which will result to Plaintiffs from the unconstitutional enforcement action. Specifically, Plaintiffs will suffer irreparable harm because the violation of a constitutional right, standing alone, constitutes an irreparable injury. Moreover, the ALJ’s Initial Decision, which is posted online, threatens to irreparably harm Plaintiffs’ business and reputation. Furthermore, if Plaintiffs were to lose on their appeal to the SEC, the Plaintiffs will have to endure bars and suspensions and will be subject to a cease and desist order that will prohibit Plaintiffs from raising any monies for any new funds for five years.

### **Jurisdiction, Venue, and Parties**

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

11. 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.

12. Plaintiff Timbervest, LLC ("Timbervest") is a Georgia limited liability company having its principal place of business in Atlanta, Georgia. Timbervest is a registered investment advisor.

13. Timbervest manages timberland and other environmental assets on behalf of various investment funds.

14. Plaintiff Shapiro is the Chief Executive Officer of Timbervest.

15. Plaintiff Boden is the Chief Investment Officer of Timbervest.

16. Plaintiff Zell is the Chief Operating Officer of Timbervest.

17. Plaintiff Jones is the President of Timbervest.

18. Plaintiffs Shapiro, Boden, and Zell are the current owners of Timbervest, through a wholly-owned holding company, Ironwood Capital Partners, LLC ("Ironwood"). Ironwood is a Georgia limited liability company. Plaintiff Shapiro is a 50% owner of Ironwood and Plaintiffs Boden and Zell each own 25%.

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

### **Background**

20. Timbervest, LLC and the four individual Plaintiffs, who serve as officers of Timbervest, provide professional timberland and timberland-related investment and management services. Timberland is generally an attractive

investment class because it historically has provided returns that are competitive with other major asset classes but with a lower return volatility.

21. Timbervest currently manages three commingled timberland funds and three commingled environmental funds with approximately \$1.2 billion in assets. It employs more than 30 individuals, including investment, forestry, legal, marketing, investor relations, and accounting professionals.

22. In 2010, the SEC's Division of Enforcement began investigating Timbervest's policies and methods for valuing timberland properties. On September 24, 2013, after three years of investigation, the SEC instituted this action against Timbervest and the individual Plaintiffs.

23. The SEC did not allege that Timbervest's valuation policies or procedures were inappropriate in any way. Instead, the SEC alleged that Timbervest violated § 206 of the Investment Advisers Act by (1) failing to disclose fees earned from selling two properties, and (2) selling one of the properties to a third party and then later purchasing the property on behalf of a separate Timbervest fund.

24. The property transactions that were the subject of the OIP took place in 2006 and 2007, and the SEC's claims were brought well outside of the applicable five-year statute of limitations.

25. The SEC originally ordered that Chief Judge Brenda P. Murray preside at the hearing of the matter. On December 16, 2013, Chief Judge Murray designated ALJ Cameron Elliot to preside over the matter.

26. ALJ Elliot has been an SEC ALJ since 2011 and during his tenure has decided 100% of his cases in favor of the Commission. In a February 2014 article, Reuters reported that Judge Elliot “has issued more than 50 ‘initial decisions’ at the SEC, and while the SEC has not always gotten everything it wanted, he has yet to rule against the agency.” Sarah Lynch, *SEC Judge Who Took on Big Four Known for Big Moves*, Reuters, Feb. 3, 2014.

27. ALJ Elliot presided over the hearing, which took place over the course of eight non-consecutive days.

28. Given the age of the case, the primary evidence presented in support of the Division’s alleged violations was the faded and inconsistent memories of two Division witnesses. As to one of those witnesses, Plaintiffs argued that the SEC had in its possession *Brady* material that the Commission’s staff disagreed with and argued was inadvertently produced. The *Brady* material consisted of notes of two interviews the Commission’s staff conducted with that witness. The Plaintiffs argued that the notes were exculpatory and, at the very least, were inconsistent statements that were required to be produced. Pursuant to the SEC’s own administrative proceeding rules, it is required to produce *Brady* material. Even though the SEC conducted an investigation that lasted over three years, speaking to numerous individuals over that time, the Commission’s staff did not produce any documents or information that it identified as *Brady* to the Plaintiffs. Ultimately, ALJ Elliot, as well as ALJ Murray, ruled in favor of the Commission’s staff that the notes were not *Brady*, even though the notes were clearly inconsistent and exculpatory.

29. ALJ Elliot also allowed the Commission's staff to introduce evidence and allegations that were not pled in the OIP and were unrelated to any of the allegations in the OIP.

30. 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 and abetting and causing those violations.

31. ALJ Elliot ordered the Plaintiffs to cease and desist from committing or causing violations of 206 (1) and (2) and ordered disgorgement of approximately \$1.9 million, plus additional prejudgment interest.

32. ALJ Elliot's decision turned heavily on several credibility determinations, all of which went against Plaintiffs.

33. On October 30, 2014, Timbervest appealed ALJ Elliot's decision to the SEC. In that appeal, Plaintiffs argued both that the evidence did not support a finding of violations or the imposition of sanctions and that the SEC's administrative forum was unconstitutional. Oral argument in the appeal was heard on June 8, 2015.

34. Prior to oral argument, on May 6, 2016, the Wall Street Journal published an article titled "SEC Wins With In-House Judges" in which a former SEC ALJ stated that she was pressured to rule in favor of the Commission. Specifically, the article states—

**Bias Allegation**

One former SEC judge said she thought the system was slanted against defendants at times. Lillian McEwen, who

was an SEC judge from 1995 to 2007, said she came under fire from Ms. Murray for finding too often in favor of defendants.

“She questioned my loyalty to the SEC,” Ms. McEwen said in an interview, adding that she retired as a result of the criticism.

Former ALJ McEwen is quoted as stating that “the SEC in-house judges were expected to work on the assumption that ‘the burden was on the people who were accused to show that they didn’t do what the agency said they did.’” Jean Eaglesham, *SEC Wins With In-House Judges*, Wall Street Journal, May 6, 2015. ALJ Murray initially presided over Plaintiffs’ hearing and is the Chief ALJ who supervises and is involved in the process of hiring ALJs for the SEC. Based on that article, Respondents requested that the Commission produce documents and information that was relevant to the statements made by the former SEC ALJ because that information is relevant to Plaintiffs’ claim that the SEC’s administrative process violates Plaintiffs’ right to due process because of a lack of impartiality.

35. On May 11, 2015, Respondents learned that at a hearing in a case pending in the Southern District of New York, *Tilton v. Securities and Exchange Commission*, 15 cv 2472 (S.D.N.Y.), which raises similar constitutional issues as here, attorneys for the SEC stated that the Commission did not appoint the ALJ in the underlying SEC administrative proceeding instituted against Tilton. (Tilton May 11, 2015 Hearing Transcript at 26.) Based on that information, Plaintiffs requested that the Commission produce information as how ALJ Elliot and Chief

ALJ Murray were appointed by the Commission.

36. On May 27, 2015, the Commission ordered that its staff produce an affidavit setting forth how ALJ Elliot and Chief ALJ Murray “were hired, including the method of selection and appointment.” On June 4, the Commission’s staff produced an affidavit that stated that “ALJ Elliot was not hired through a process involving the approval of the individual members of the Commission.” The affidavit included no information as to how Chief ALJ Murray was hired or appointed, but in a memo filed by the Commission’s staff, they state that “Chief ALJ Murray began work at the agency in 1988 and information regarding hiring practices at that time is not readily available.”

37. On June 4, 2015, the Commission issued an order responding to Plaintiffs’ request for discovery on the issue of ALJ bias. In that order, the Commission stated that its consideration of Plaintiffs’ motion “would be assisted by the submission of certain additional material for inclusion in the record” and requested that SEC ALJ Elliot provide an affidavit “addressing whether he has had any communications or experience any pressure similar to that alleged in the May 6, 2015 The Wall Street Journal article, ‘SEC Wins With In-House Judges,’ and whether he is aware of any specific instances in which any other Commission ALJ has had such communications or experience such pressure. ALJ Elliot is also invited to include in his affidavit any other matter pertaining to allegations of bias or partiality that he may consider pertinent or wish to address.” The Commission’s order stated that if ALJ Elliot determined to submit an affidavit, he should notify the Commission’s Secretary on or before July 1, 2015. On June 10, 2015, Plaintiffs

learned that ALJ Elliot notified the Commission's Secretary that he would not submit an affidavit.

38. On June 8, 2015, Plaintiffs appeared before the Commission for oral argument. Later that day, the court in *Hill v. SEC*, Civil Action No. 1:15-CV-1801-LMM, at 13 (N.D. Ga. June 8, 2015), which is pending in this court and asserts the very same Appointments Clause argument that is raised herein, granted a preliminary injunction for the plaintiff finding that there was a substantial likelihood of success on the merits of plaintiff's Appointments Clause argument and enjoined the SEC's administrative proceeding.

39. Plaintiffs bring this case in federal court because they will be unable to meaningfully litigate their constitutional challenges before the Commission. The Commission is the very body that failed to properly appoint ALJ Elliot. It would be inherently difficult for the Commission to consider Plaintiffs' constitutional claims in a neutral and objective way, given its responsibility for its own administrative proceedings, its allowance of improper ALJ designations, and the fact that it sent this matter to an ALJ for resolution.

### **The Administrative Proceeding**

40. 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.

41. 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 allow respondents to assert counterclaims against the SEC. Federal court defendants may assert counterclaims against their adversaries.

g. 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.

42. 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. 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 very different. 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.

43. Moreover, any appeal of an SEC ALJ's decision is heard by the SEC itself, the very body that authorizes the bringing of the administrative proceeding in the first place. 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 be appealable to a United States Court of Appeals.

#### **SEC ALJs**

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

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

45. 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**

46. 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 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.

47. 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.

48. 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.

49. 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).

**The Position of SEC ALJ**

50. The SEC is a “Department” of the Executive Branch of the U.S. Government. *Free Enterprise*, 130 S. Ct. at 3163.

51. 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.

52. 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 45.a through 45.rr and 46 through 49. 15 U.S.C. § 78d-1.

53. 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.”).

54. 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.)

55. 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.

56. SEC ALJs are hired after interviews with the Chief ALJ and an interview committee.

57. SEC ALJs are not appointed by the President, the courts, or the Commissioners.

58. 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.

59. SEC ALJs are inferior “officers” of the United States due, among other things, to the significant authority they exercise; the broad discretion they are afforded; their career appointments; 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**

60. 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).

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

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

63. 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).

64. 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 Administrative Proceeding Violates Article II Because  
ALJs Are Not Appointed By the President, the Courts, or  
the Head of the Department**

65. The Constitution’s Article II, Section 2 states that only the following have authority to appoint “inferior officers” like ALJs: the President, the courts of law, or the “heads of departments.” Art. II, § 2, cl. 2.

66. The SEC is a “Department” under Article II, and its Commissioners are the Department “heads.” *Free Enterprise*, 561 U.S. at 511-13 (2010).

67. Despite their crucial role and extensive powers as inferior officers, the SEC ALJs are not appointed by the President, the Courts, or the Commissioners. Instead, they are hired by the SEC’s Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resource functions, the Office of Personnel Management, and an interview committee. In some cases, other federal agencies have simply transferred ALJs to the SEC.

68. The Commissioners themselves are not involved in appointing ALJs, nor are the courts or the President. Thus, the appointment of ALJs like the one presiding over Plaintiffs’ administrative proceeding is unconstitutional.

69. Because the ALJ presiding over Plaintiffs’ administrative proceeding was appointed in violation of Article II, the proceeding is unconstitutional.

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

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

71. 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.

72. 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.

73. 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;

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.

74. Under this 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)).

75. 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 Irreparable Harm**

76. ALJ Elliot's decision turned heavily on a number of credibility determinations, all of which were negative to Plaintiffs. The SEC accepts an ALJ's credibility determinations unless there is "overwhelming evidence to the contrary." *Clawson*, 2003 WL 21539920, at \*2 (July 9, 2003). The SEC is in no position to overturn or even meaningfully review such determinations because it cannot assess the demeanor of witnesses. Any final decision therefore will necessarily be infected by the constitutional infirmities in the administrative proceeding.

77. Without injunctive relief from this Court, Plaintiffs' due process rights to a meaningful review will be violated. 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.

78. Moreover, the ALJ's Initial Decision that is the direct product of an unconstitutional process is posted online and threatens to irreparably harm Plaintiffs' business and reputation.

79. Furthermore, if the SEC imposes the relief requested by its staff, the Plaintiffs will have to endure bars and suspensions and will be subject to a cease and desist order that will prohibit Plaintiffs from raising any monies for any new funds for five years. The damage from a ruling of the Commission affirming the Initial Decision of the ALJ or providing other relief sought by the Division would be severe and irreversible before Plaintiffs could obtain meaningful judicial review of the Article II claim.

80. This harm, which threatens to damage Plaintiffs' business, would be irreparable. The availability of an appeal after an administrative proceeding to a federal circuit court of appeals cannot avoid it or reverse it, because the administratively-imposed sanction may already have taken effect by the time the appellate court makes a ruling.

81. The harm cannot be effectively 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.

82. 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.

## **COUNT ONE**

### **APPLICATION FOR INJUNCTIVE RELIEF**

83. Plaintiffs repeat and re-allege paragraphs 1 through 82 as if set forth herein in full.

84. Plaintiffs' constitutional rights will be irreparably harmed if a permanent injunction (and, if necessary, a preliminary injunction and temporary

restraining order) are not issued to stay the effect of the SEC proceeding and prevent continued publication of the Initial Decision.

85. Plaintiffs have a substantial likelihood of success on the merits of their claim.

86. 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.

87. Finally, the grant of an injunction will serve the public interest in the protection of parties' constitutional rights.

## **COUNT TWO**

### **DECLARATORY JUDGMENT**

88. Plaintiffs repeat and re-allege paragraphs 1 through 87 as if set forth herein in full.

89. Plaintiffs request a declaratory judgment that the statutory and regulatory provisions providing for the positions and tenure protections of SEC ALJs are unconstitutional and that proceedings and decisions involving hearings before ALJs so appointed and tenure-protected are invalid and of no force and effect.

### **Jury Demand**

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 and declaring proceedings and decisions involving hearings before such ALJs to be invalid and ineffective.

B. An order and judgment: (1) enjoining the SEC from the public dissemination and/or publication, in written or other form, of the SEC ALJ's Initial Decision in the administrative proceeding, including directing the removal of the SEC ALJ's Initial Decision from the following link: <https://www.sec.gov/alj/aljdec/2014/id658ce.pdf>; (2) enjoining the SEC from public dissemination and/or publication, in written or other form, of any final order from the SEC in the administrative proceeding, or, in the alternative, staying the administrative proceeding; and (3) staying the effect of any relief entered against Plaintiffs in the administrative proceeding, pending resolution of this matter.

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

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