

Securities Regulation Daily Wrap Up, ENFORCEMENT—N.D. Ga.: Adviser wages another attack on constitutionality of ALJ proceedings, (Jun. 15, 2015)

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By Amy Leisinger, J.D.

An investment adviser and certain of its executives have filed a complaint for declaratory and injunctive relief in the line of the cases challenging the propriety of the SEC's use of administrative proceedings and the constitutionality of the appointments and decisions of administrative law judges (ALJs). According to the complaint, unless the Commission is restrained in its activities, the plaintiffs will be required to submit to irreparable injury of an unconstitutional proceeding lacking the safeguards provided within the court system. The parties also moved for an order temporarily restraining or preliminarily enjoining the SEC from publicly disseminating the decision against them in the administrative proceeding and staying the effect of any relief entered pending resolution of the matter (*Timbervest, LLC v. SEC*, June 12, 2015).

Background. Timbervest, LLC is an SEC-registered investment adviser that manages approximately \$1.2 billion in investments related to timber and environmental remediation through various client funds. In September 2013, the SEC instituted administrative proceedings against Timbervest and four of its executives, alleging that Timbervest sold a tract of timberland on behalf of a client and caused the client to pay a brokerage fee without disclosing the fee. The SEC also alleged that Timbervest repurchased the same property a few months later on behalf of a different client pursuant to a side agreement and that this was not disclosed to either client.

In August 2014, an ALJ issued an initial decision finding that Timbervest violated Advisers Act Sections 206(1) and 206(2) and that the individual respondents caused, aided, and abetted the violations. The ALJ ordered the plaintiffs to cease and desist from committing or causing further violations of the provisions and ordered disgorgement of approximately \$1.9 million, plus prejudgment interest.

Both Timbervest and the Division of Enforcement appealed the initial decision to the full Commission, and, at oral argument (covered in the *Securities Regulation Daily Wrap Up* for June 8, 2015), counsel for Timbervest and the individual respondents contested the ALJ's initial decision on both substantive and constitutional grounds. According to the parties, the evidence making up the record was insufficient to support a finding against them, and the SEC's ALJ proceedings are unconstitutional under Article II of the U.S. Constitution because ALJs are "inferior officers" that may not be separated from presidential supervision and removal by more than one layer of protection.

Injunctive relief and declaratory judgment. In their complaint, the plaintiffs stated that they have appealed the ALJ's decision to the Commission but noted that the appeal would be "futile," as the Commission itself did not properly appoint the ALJ and has argued in other cases that its administrative forum is constitutional. "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," the plaintiffs explain. As such, the plaintiffs explained, an action in federal court is necessary to "meaningfully litigate" their constitutional challenges.

According to the complaint, SEC ALJs are inferior "officers" of under the U.S. Constitution as a result of their broad discretion to exercise significant power. Article II of the U.S Constitution vests the sole power to appoint inferior officers in the President, the courts, and the "heads of departments," and SEC ALJs are not appointed by any of these, the plaintiffs note. Further, ALJs receive career appointments and are only removable by the SEC for "good cause," the plaintiffs contend, and, as such, ALJs are shielded by at least two levels of tenure protection—the "good cause" standard and the Commissioners' own tenure. According to the U.S. Supreme

Court, inferior officers may not be separated from Presidential supervision and removal by more than one layer of tenure protection, and, as such, the SEC's administrative proceedings are unconstitutional, the plaintiffs reason.

The plaintiffs argue that declaratory and injunctive relief is necessary to prevent the irreparable injury that will result from the unconstitutional enforcement action and the threat to their business and reputation. Further, the plaintiffs contend, without injunctive relief, their due process right to a meaningful review will be violated, which, on its own, qualifies as an irreparable injury. These types of harm "cannot be effectively remedied after the fact by money damages," the plaintiffs conclude.

The case is No. 1:15-CV-2106.

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Companies: Timbervest, LLC

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