Oral Argument Not Yet Scheduled

IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

15-1416

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

Petitioners,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON APPEAL FROM THE SECURITIES AND EXCHANGE COMMISSION

INITIAL BRIEF FOR PETITIONERS

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

In accordance with Circuit Rule 28, Petitioners Timbervest, LLC, Joel Barth Shapiro, Walter William Anthony Boden, II, Donald David Zell, Jr., and Gordon Jones II respectfully submit this Certificate as to Parties, Rulings, and Related Cases:

A. Parties

The parties that appeared before the United States Securities and Exchange Commission are Petitioners Timbervest, LLC, Joel Barth Shapiro, Walter William Anthony Boden, II, Donald David Zell, Jr., and Gordon Jones II, who are petitioners in this Court.

The SEC is the respondent in this Court.

The Securities Industry and Financial Markets Association and the Cato Institute have given notice that they intend to file a brief in this matter as amici curiae in support of Petitioners. Washington Legal Foundation, Ironridge Global IV, Ltd., and Ironridge Global Partners, LLC have indicated that they intend to file a brief in this matter as amici curiae in support of Petitioners.

There are currently no intervenors.

B. Rulings Under Review

Petitioners seek review of the final decision and order of the Commission captioned *In the Matter of Timbervest, LLC, et al.*, Opinion of the Commission, In-

vestment Advisers Act Release No. 4197, Admin Proc. File No. 3-15519, 2015 WL 5472520 (Sept. 17, 2015) (J.A.__); *In the Matter of Timbervest LLC, et al.*, Order Imposing Remedial Sanctions, Investment Advisers Act Release No. 4197, Admin. Proc. File No. 3-15519 (Sept. 17, 2015) (J.A.__.)

C. Related Cases

This matter has not previously been before this Court. Counsel for Petitioners are not aware of any related cases currently pending in this Court or in any other court within the meaning of Circuit Rule 28(a)(1)(C).

Counsel for Petitioners note, however, that one of the legal issues presented in this case—the constitutionality of the method of appointment of the Commission's administrative law judges—has been raised in a number of other proceedings and courts around the country, including the following:

- *Pierce v. SEC*, No. 15-901 (U.S.)
- *Raymond J. Lucia Companies, Inc. v. SEC*, No. 15-1345 (D.C. Cir.)
- *Chau v. SEC*, No. 15-461 (2d Cir.)
- *Duka v. SEC*, No. 15-2732 (2d Cir.)
- *Tilton v. SEC*, No. 15-2103 (2d Cir.)
- *Bennett v. SEC*, No. 15-2584 (4th Cir.)
- *Feathers v. SEC*, No. 15-7012 (9th Cir.)
- *Gray Financial Group Inc. v. SEC*, No. 15-13738 (11th Cir.)

- *Hill v. SEC*, No. 15-12831 (11th Cir.) (consolidated with *Gray Financial*, No. 15-13738, *supra*)

- *Imperato v. SEC*, No. 15-11574 (11th Cir.)

- *Ironridge Global IV, Ltd. v. SEC*, No. 15-cv-2512 (N.D. Ga. Nov. 17, 2015) (stayed pending Eleventh Circuit decisions in *Gray* and *Hill*, *supra*)

CORPORATE DISCLOSURE STATEMENT OF TIMBERVEST, LLC

In accordance with Federal Rule of Appellate Procedure 26.1 and this Court's Rule 26.1, Petitioners respectfully submit the following corporate disclosure statement:

Timbervest, LLC is a Georgia limited liability company. Timbervest is owned by Ironwood Capital Partners, LLC, a Georgia limited liability company. Ironwood Capital Partners is owned by petitioners Joel Barth Shapiro, Walter William Anthony Boden III, and Donald David Zell, Jr. No publicly held corporation owns 10% or greater ownership interest in Timbervest.

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*Authorities upon which we chiefly rely are marked with asterisks.

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GLOSSARY

Advisers Act	Investment Advisers Act of 1940
Alabama Property	New Forestry property in Alabama sold to Chen Timber, LLC on October 17, 2006 and later purchased by Timbervest Partners, LP on February 1, 2007
ALJ	Administrative Law Judge
APA	Administrative Procedure Act
Barag	Jerry Barag, Timbervest partner from 2003 to 2004
Chambers	Bob Chambers, former Timbervest manager
Chen	Chen Timber, LLC
Chen Transactions	The sale of a property in Alabama by New Forestry to Chen Timber, LLC on October 17, 2006 and later purchase of that property by Timbervest Partners, LP on February 1, 2007
CRJ	Copyright Royalty Board Judges
Division	United States Securities and Exchange Commission Division of Enforcement
FDIC	Federal Deposit Insurance Corporation
Final SEC OIG Report	Securities Exchange Commission Office of the Inspector General Final Report of Investigation, Case # 15-ALJ-0482-I
Hailey	Reid Hailey
HBU	Higher-and-better use
Initial Decision or ID	August 20, 2014 Initial Decision by ALJ Cameron Elliot
IRS	Internal Revenue Service
June 2012 emails	June 5 and 8, 2012 emails memorializing conversation between Securities and Exchange Commission staff and Ed Schwartz
LLC	Limited liability company
MSPB	Merit Systems Protection Board

OIG	Securities and Exchange Commission Office of the Inspector General
OIP	September 24, 2013 Order Instituting Proceedings
Opinion	September 17, 2015 Opinion of the Commission
Partners	Petitioners Joel Shapiro, William Walter Anthony Boden II, Donald David Zell, Jr., and Gordon Jones II
STJ	Special Trial Judge

STATEMENT OF JURISDICTION

The SEC's opinion and order were issued on September 17, 2015. J.A.__[Opinion.1; Order.1.] On November 13, 2015, Petitioners timely filed a petition for review in this Court, which has jurisdiction under 15 U.S.C. §78y.

PERTINENT STATUTES AND REGULATIONS

Pertinent constitutional, statutory, and regulatory provisions are reproduced in the separately bound Addendum.

STATEMENT OF THE ISSUES

1. Whether the five-year statute of limitations in 28 U.S.C. §2462 barred the SEC's enforcement action and the relief ordered by the SEC.

2. Whether the SEC violated Petitioners' due process and equal protection rights by depriving Petitioners of a fair and impartial forum and other fundamental due process procedural protections.

3. Whether the underlying SEC administrative enforcement proceeding was unconstitutional because SEC ALJs have not been appointed in accordance with the Appointments Clause of the Constitution and enjoy more than one layer of tenure protection.

4. Whether the SEC's finding of liability and imposition of sanctions under the Investment Advisers Act of 1940 ("Advisers Act") was arbitrary and capricious, an abuse of discretion, contrary to law, or not supported by substantial evidence.

STANDARD OF REVIEW

This Court reviews legal and constitutional questions *de novo* and "owes no deference to [an] agency's pronouncement on a constitutional question." *J.J. Cassone Bakery, Inc. v. NLRB*, 554 F.3d 1041, 1044 (D.C. Cir. 2009) (quotation omitted). It will uphold the SEC's factual findings only if supported by substantial evidence, 15 U.S.C. §78y(a)(4), and will set aside the agency's decision if it is "'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law,'" *Rapoport v. SEC*, 682 F.3d 98, 103 (D.C. Cir. 2012) (quoting 5 U.S.C. §706(2)(A)). SEC action is arbitrary if, *inter alia*, the SEC fails to comply with its "own standard." *WHX Corp. v. SEC*, 362 F.3d 854, 859 (D.C. Cir. 2004).

STATEMENT OF THE CASE

I. Underlying Proceedings

In September 2013, after spending nearly three years investigating Timbervest's valuation policies, the SEC charged Petitioners with violating the Advisers Act based on conduct unrelated to those valuation policies. J.A.__[2013.09.24-Order.Instituting.Proceedings.("OIP").] The SEC alleged that Petitioners committed fraud (1) when they sold a property in Alabama (the "Alabama Property") on behalf of one client in 2006 and later purchased that same property on behalf of another client in early 2007 under an alleged sale-and-repurchase agreement, and (2) when a Timbervest partner, Boden, received allegedly unauthorized and undis-

closed fees on the sale of the Alabama Property in 2006 and on another sale of property located in Kentucky in 2007. J.A.__[OIP.]

Instead of bringing the enforcement action in federal court, the SEC brought the action in its own administrative forum, where respondents have no right to a jury, no right to discovery, no rules of evidence, and in which an SEC ALJ (whom the SEC incorrectly characterizes as a mere employee) presides over the trial. Unsurprisingly, the SEC almost never loses when it has the home-field advantage, its own referees, and is subject to few if any of the protections provided to defendants in federal court.

After an eight-day hearing, the SEC's ALJ found that Petitioners violated §§206(1) and (2) and imposed cease-and-desist orders and disgorgement. J.A.__[2014.08.20.Initial.Decision.("ID").1-2.] Consistent with this Circuit's precedent and with prior SEC opinions, the ALJ determined that the requested associational bars, which would permanently bar Petitioners from associating with an investment adviser, were barred by the statute of limitations. J.A.__[ID.63.] Petitioners sought the Commission's review of the ALJ's decision, and the Commission granted that review. J.A.__[2014.09.10-Petition.for.Review; 2014.09.30-Order.Granting.Petition.for.Review.]

During the pendency of the Commission's review of the Initial Decision, Petitioners learned that, in violation of the Appointments Clause, the Commission did

not appoint the ALJ that presided over Petitioners' hearing. J.A.__[2015.06.04.Notice.Filing.] Further, the Wall Street Journal published an article in which a former SEC ALJ stated that she had been pressured to rule in favor of the agency. J.A.__[2015.05.20.Respondents.Motion.Additional.Evidence.Ex.1.] Petitioners raised these issues, along with other challenges to the ALJ's findings, in their appeal to the Commission. J.A.__[2014.09.10.Petition.for.Review; 2015.07.01.Respondents-Brief.]

Despite there being no substantial evidence of violations, the Commission upheld the ALJ's findings against Petitioners, and then reversed the ALJ's finding as to the statute of limitations and imposed bars because it determined that Petitioners "pose a substantial degree of risk to the investing public." J.A.__[Opinion.28.] The SEC then voluntarily stayed its own relief and allowed Petitioners to remain in business until this appeal is resolved. J.A.__[2015.09.17-Stay.Order.]

II. Underlying Facts

A. Petitioners have been in business for two decades with an unblemished compliance record.

Timbervest is a registered investment adviser that was established in 1995 to provide professional timberland-related investment and management services. J.A.__[Transcript.71-72.] New Forestry was Timbervest's first and largest separate

account, funded with pension funds from BellSouth.[1] J.A.__[Transcript.73, 1510.] Timbervest formed the Timbervest Partners, L.P. fund ("TVP") in 2004, which was Timbervest's first commingled fund that pooled investments from a variety of investors rather than from a single investor. J.A.__[Transcript.55-56, 58-59.] Timbervest has formed and managed multiple commingled funds and two separate accounts with investments totaling over $1.45 billion since 2002. J.A.__[2013.11.08.Shapiro.Declaration.¶7; Transcript.460, 1693.]

Timbervest's Partners[2] each came to Timbervest between 2002 and 2004. Joel Shapiro joined as CEO in 2002. J.A.__[Transcript.1691-93.] Shapiro had previously been in the securities industry at broker-dealer and investment advisor firms from 1986 through 1995. J.A.__[Transcript.1682-84.] Gordon Jones was President and General Counsel at Timbervest and joined in 2004. J.A.__[Transcript.1233.] David Zell, Timbervest's Chief Operating Officer, came to Timbervest in 2003. J.A.__[Transcript.1533.] Zell has more than 25 years' experience in the real estate, investment, and financial services industries. J.A.__[Transcript.1532-35.] Prior to joining Timbervest, he was responsible for managing the real estate and natural resource investments for BellSouth's pension and other trusts. J.A.__[1534.] Boden, Timbervest's Chief Investment Officer, first

[1] BellSouth was acquired by AT&T in December 2006.

[2] Petitioners Shapiro, Boden, Zell, and Jones are collectively the "Partners."

came to Timbervest in 2002 as a consultant. J.A.__[Transcript.70-71.] Boden has more than 25 years' experience in the real estate investment, development, and consulting industries. J.A.__[Transcript.48-51.]

Aside from the allegations in this case, Petitioners have an unblemished compliance record during their decades in business and oversight of more than a billion dollars in assets. No other allegations of wrongdoing have ever been made.

B. Timbervest disclosed Boden's fee arrangement.

Upon becoming Timbervest's CEO, Shapiro recruited and engaged Boden as a consultant, tasking Boden with assessing, organizing, and managing the south-eastern property sales for New Forestry, given Boden's expertise in the real estate industry. J.A.__[Transcript.92-93, 393-94, 1699, 1750.] In exchange for his work, Boden agreed to a sliding-scale fee upon the disposition of New Forestry's eight largest holdings in the Southeast. J.A.__[Div.Ex.127.p.2; Transcript.393-94.] The agreement had a five-year term, so Boden would be entitled to a fee only if a property sold prior to the end of 2007. J.A.__[Div.Ex.127.p.2.]

Boden worked under the fee arrangement for two years without any other compensation from Timbervest, until he became a Partner in 2004. J.A.__[Transcript.148, 392-93, 1829.] Recognizing the potential conflict of interest that could arise because of Boden's new status as a partner, Shapiro orally disclosed the fee arrangement to Ed Schwartz, the principal of ORG Portfolio Man-

agement ("ORG"). J.A.__[Transcript.1325, 1756, 1774, 1776-77.] At the time, ORG served as BellSouth's investment manager and New Forestry's discretionary oversight manager. J.A.__[Transcript.1579, 2037-38.] There is no dispute that Shapiro and Schwartz had a conversation in 2005, but given the seven years that passed between the conversation and the SEC first asking questions about it, Shapiro and Schwartz have different memories of the details. J.A.__[Transcript.1778-79, 2057.]

Boden ultimately received $470,750 in connection with the sale of the Alabama Property on October 17, 2006 and $685,486.25 in connection with the sale of property in Kentucky on April 3, 2007. J.A.__[Div.Ex.11; Resp.Ex.34.] Both properties fell within the ambit of Boden's fee arrangement for work he had previously performed. J.A.__[Div.Ex.127; Transcript.505-06, 1490-91, 1771.] At least one other property that was covered by the fee arrangement sold outside the arrangement's five-year term, and so Boden did not receive a fee for his work relating to that property. J.A.__[Div.Ex.127; Div.Ex.43; Transcript.447-49.]

C. Timbervest did not enter into a roundtrip transaction.

In 2006, Timbervest sold the Alabama Property to an unrelated third party, Chen Timber, LLC ("Chen"). [Div.Ex.11.] Timbervest marketed the Alabama Property because New Forestry mandated a reduction in the size of its portfolio from $471 million to $250 million, with a specific emphasis on selling non-income

producing properties such as the Alabama Property. J.A.__[Div.Ex.6; Div.Ex.47; Transcript.102-03, 476.] Boden and Lee Wooddall, the principal at Chen, first negotiated the sale in the early summer of 2006. J.A.__[Transcript.137.] The final contract was signed on September 15, 2006, and the transaction closed on October 17, 2006. J.A.__[Div.Ex.11.]

At the time of the negotiations and sale, all the economic metrics available to Timbervest indicated that the sale price was substantially above the property's independently appraised value and Timbervest's internal valuation. J.A.__[Resp.Ex.5; Resp.Ex.41; Resp.Ex.52; Div.Ex.26; Transcript.203-07, 209-10, 1661.] *Infra* PartVII.A.1.b.

After the sale of the Alabama Property, the price for pulpwood (the majority of the trees on the property) substantially increased, and the volume of timber on the property grew. J.A.__[Transcript.200-01.] Additionally, nearby properties that Timbervest managed went under contract at stronger-than-expected land prices. J.A.__[Transcript.203-04, 1664.]

At the same time, Timbervest was actively seeking properties for the TVP fund. J.A.__[Transcript.82-83.] Given Timbervest's familiarity with the Alabama Property and the increased pulpwood prices, Boden and Wooddall discussed the possibility of TVP purchasing it. J.A.__[Resp.Ex.19.] Timbervest then sent a draft purchase agreement to Wooddall on November 30, 2006. J.A.__[Resp.Ex.19.]

Timbervest and Chen executed a purchase and sale agreement on December 15, 2006, and after due diligence, the sale closed on February 1, 2007. J.A.__[Div.Ex.18; Resp.Ex.7.] Although TVP paid more for the Alabama Property than Chen had paid, the entire price increase is accounted for by the documented increased volume and value of the timber on the property. J.A.__[Transcript.200-201.]

The SEC contends that the Chen Transactions were a prearranged, roundtrip sale-and-repurchase agreement between Wooddall and Boden based solely on Wooddall's flawed memory that Wooddall gave Boden a "verbal option" to repurchase the property. J.A.__[Opinion.8; Transcript.768.] *Infra* PartVI.A.2. This testimony itself contradicts the only written evidence, which states that the sale was "not contingent upon any other agreement or understanding." J.A.__[Div.Ex.11.p.963342.] But Wooddall's unclear memory of the transactions is to be expected, given that more than five years passed between the time of TVP's purchase of the Alabama Property and the SEC first asking him questions about the deal.

SUMMARY OF THE ARGUMENT

The SEC's Opinion must be vacated.

First, 28 U.S.C. §2462 prohibits the SEC from bringing actions for a civil fine, penalty, or forfeiture more than five years after a claim's accrual. Here, the

SEC brought an action seeking penalties and forfeitures more than five years after the alleged misconduct.

Second, the SEC violated Petitioners' due process and equal protection rights by arbitrarily subjecting them to an administrative, rather than judicial, enforcement proceeding, and by depriving Petitioners of a fair and impartial forum and other fundamental due process rights.

Third, the SEC has violated the Appointments Clause because its ALJs are "inferior Officers" who were not properly appointed and has violated Separation of Powers principles because its ALJs are impermissibly protected by more than one layer of good-cause removal protection.

Fourth, the SEC found violations of the Advisers Act and imposed inappropriate sanctions based on findings that were not supported by substantial evidence.

STANDING

Petitioners have standing as "person[s] aggrieved by a final order of the Commission." 15 U.S.C. §78y(a)(1); *see also Sierra Club v. EPA*, 292 F.3d 895, 900 (D.C. Cir. 2002).

ARGUMENT

I. The SEC's enforcement action was time-barred under 28 U.S.C. §2462.

SEC enforcement actions are subject to the five-year statute of limitations in 28 U.S.C. §2462, which provides that "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not

be entertained unless commenced within five years from the date when the claim first accrued . . . ."

As the Supreme Court has recently stated, §2462 is necessary to avoid "leav[ing] defendants exposed to Government enforcement action not only for five years after their misdeeds, but for an additional uncertain period into the future." *Gabelli v. SEC*, 133 S. Ct. 1216, 1223 (2013). It "would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time." *Id.* (marks omitted).

Section 2462 protects targets of government action by "preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared." *Id.* at 1221. Here, the SEC brought claims nearly seven years after the last alleged misconduct, and the Division's two key witnesses have had varying recollections about the transactions at issue.[3] Indeed, nearly all of the witnesses could not recall specific details of many key events, and documentary evidence that may have existed at one point has long since been lost. J.A.__[172, 589, 805, 884, 942, 1317, 1548,

[3] Wooddall, for example, gave varying testimony over the course of the investigation and hearing about whether there initially had been an agreement as to the price of the Alabama Property on repurchase and when he and Boden first discussed a repurchase. J.A.__[Div.Ex.74.p.7-11; Stone.Decl.Ex.A.p.16-17; Transcript.771.] Schwartz, likewise, gave differing accounts of whether he consented to Boden's fee agreement. *Infra* PartII.B.

1726, 2064, 2212-14.] None of the existing documentary evidence establishes any violations.

A. The associational bars sought and imposed by the SEC are encompassed by §2462.

Under §2462, a "penalty" is "a form of punishment imposed by the government for unlawful or proscribed conduct, which goes beyond remedying the damage caused to the harmed parties by the defendant's action." *Johnson v. SEC*, 87 F.3d 484, 488 (D.C. Cir. 1996). In *Johnson*, this Court found that a temporary suspension was a penalty. *Id.* at 488. In a footnote of its Opinion, the SEC challenges this Court's decision in *Johnson*, asserting that it was "incorrectly decided," and taking the extraordinary position that associational bars *are categorically not penalties*. J.A.__[Opinion.25 & n.71.] While recognizing that *Johnson* "states the controlling rule," the SEC stubbornly insists that associational bars are *never* penal and are *never* subject to the statute of limitations. J.A.__[Opinion.25 & n.71.]

1. *Johnson* is controlling, and contrary to the SEC's view, was correctly decided.

Johnson is the seminal case interpreting penalties under §2462. It held that a censure and temporary suspension "*clearly* resemble[d] punishment in the ordinary sense of the word" and were penalties within the meaning of §2462 because they went "beyond remedying the damage caused to the harmed parties by the defendant's actions." 87 F.3d at 488 (emphasis added). The sanctions restricted Johnson's

ability to earn a living during the suspension and had "longer-lasting repercussions on her ability to pursue her vocation." *Id.* at 489.

Although the Court stated that a sanction based on Johnson's ongoing risk to the public "would less resemble punishment," it rejected the SEC's argument that the sanctions were based on a finding that Johnson posed such a risk. *Id.* at 489-90. This Court highlighted that the SEC's allegations against Johnson in the OIP focused "almost exclusively on Johnson's failure reasonably to supervise, not her current competence or risk to the public." *Id.* at 490. The Court concluded that "[i]f the SEC really viewed Johnson as a clear and present danger to the public, it is inexplicable why it waited *more than five years* to begin the proceedings to suspend her." *Id.* at 490 n.9. Similarly here, all the events alleged in the OIP took place more than five years prior to the OIP.

Johnson commands that the associational bars imposed by the SEC—far more severe than the six-month suspension at issue in *Johnson*—be vacated. The SEC itself has long recognized that associational bars are penal under §2462. *See, e.g.*, *Gregory Trautman*, 98 SEC Docket 155, 2009 WL 6761741, at *20 (Dec. 15, 2009) (§2462 prevented consideration of conduct more than five years old in determining appropriateness of associational bar); *Warwick Capital Management, Inc.*, 92 SEC Docket 1147, 2008 WL 149127 (Jan. 16, 2008) (same). The SEC's own ALJs have also consistently held that associational bars are barred by §2462,

and the SEC has not disturbed those findings. *See, e.g.*, *David F. Banidemere*, 107 SEC Docket 2807, 2013 WL 5553898, at *75 (Oct. 8, 2013); *David E. Zilkha*, 100 SEC Docket 3265, 2011 WL 1425710, at *15 (Apr. 13, 2011); *Terence Michael Coxon*, 64 SEC Docket 712, 1997 WL 186896, at *1 (Apr. 8, 1997). The ALJ followed this controlling precedent and determined that the associational bars sought were penalties under §2462. J.A.__[ID.61-63.] And SEC Commissioner Aguilar recently confirmed that, among other purposes, associational bars "*serve to punish* the wrongdoer . . . ." Luis A. Aguilar, Setting Forth Goals for 2015: Address to Practising Law Institute's SEC Speaks in 2015 Program (Feb. 20, 2015) (emphasis added).

Likewise, this Court has consistently held that bars are penal under §2462. *See, e.g.*, *Johnson*, 87 F.3d at 488-89; *Proffitt v. FDIC*, 200 F.3d 855, 861 (D.C. Cir. 2000) (finding "plain[]" "punitive purpose" in banking bar). Other courts have agreed because when a court places limitations on the career choices available to a defendant or "exclude[s] a person from their chosen profession," a significant interest of that defendant is compromised. *SEC v. Bartek*, 484 F. App'x 949, 957, n.10 (5th Cir. 2012) (denying SEC's requested officer and director bar). Given that a lifetime bar is "the securities industry equivalent of capital punishment," *Saad v. SEC*, 718 F.3d. 904, 906 (D.C. Cir. 2013) (citation omitted), associational bars are penalties under §2462 under any reasonable interpretation.

2. The associational bars imposed here are penal because Petitioners do not represent any threat of future harm.

Even if this Court finds that associational bars are not necessarily penal if they protect the public from future harm, the bars imposed here are nevertheless penal. The SEC's own conduct in allowing Petitioners to remain in business for years since discovering the alleged misconduct demonstrates that Petitioners pose no threat to the public. The SEC began investigating Timbervest in 2010. J.A.__[Stone.Decl.Ex.FF.] Since then, the Petitioners "continue[d] to interact with the investing public and directly control[led] hundreds of millions of dollars of clients' money." J.A.__[Opinion.28.] Despite this, the SEC waited nearly 18 months after Timbervest voluntarily disclosed the transactions at issue before even bringing charges. J.A.__[OIP; Div.Ex.79.p.5; Div.Ex.80.p.2.]

When the SEC did bring charges, it acted with no urgency—it never sought emergency relief to keep the Petitioners out of the securities industry; it jointly moved to postpone the evidentiary hearing; and it granted the Chief ALJ's motion to extend time for ALJ Elliot to issue his initial decision. J.A.__[2013.10.09.Joint.Motion; 2014.08.11 Order.] The SEC did not issue its final decision until *more than a year* after ALJ Elliot's Initial Decision; it then *voluntarily stayed all sanctions pending this appeal.* J.A.__[2015.09.17.Order] As in *Johnson*, the SEC's actions are incompatible with its argument that Petitioners pre-

sent a threat of harm and demonstrate that the SEC's true motive is to punish Petitioners and not protect investors.

Nor is there any credible evidence that Petitioners pose any sort of threat. Petitioners have been in the securities industry for two decades, and the SEC has identified only two isolated incidents of alleged misconduct—each of which took place nearly a decade ago. Even if the SEC's allegations are taken as true, isolated wrongdoing is not sufficient to demonstrate a threat of future harm. *See, e.g.*, *SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995) (isolated misconduct "can in no way justify the predication that future misconduct will occur"); *SEC v. Benger*, 64 F. Supp. 3d 1136, 1143 (N.D. Ill. 2014) (rejecting "the SEC's stained and incorrect view that a defendant automatically becomes a recidivist by participating in a multi-faceted scheme.").

The SEC contends that Petitioners pose a risk of future harm in part because of how they managed a property for New Forestry (Glawson) between 2009 and 2010 that is not otherwise the subject of any of the SEC's charges. J.A.__[Opinion.28-29.] The SEC never made any allegation in the OIP that the Petitioners' management of Glawson supported a finding that bars were necessary. As in *Johnson*, an OIP that focuses "almost exclusively" on the alleged violations and not a threat of future misconduct cannot justify a bar. 87 F.3d at 490.

B. The disgorgement remedy sought and imposed by the SEC is encompassed by §2462.

The SEC ordered Petitioners to pay to the federal government the disposition fee that Timbervest earned on the sale of the Alabama Property. J.A.__[Opinion.31.] That measure of disgorgement constitutes a penalty. Moreover, any disgorgement is a forfeiture subject to §2462.

1. Disgorgement operates as a penalty in this case.

Petitioners recognize that this Court has held that disgorgement is not always a penalty. *Zacharias v. SEC*, 569 F.3d 458 (D.C. Cir. 2009). But applying the standard enunciated in *Johnson*, disgorgement operates as a penalty here.

Disgorgement can be a penalty if it goes beyond "remedying the damage caused to the harmed parties." *Johnson*, 87 F.3d at 488. *See also SEC v. First City Fin'l Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989) ("[D]isgorgement may not be used punitively."); *SEC v. ETS Payphones, Inc.*, 408 F.3d 727, 735 (11th Cir. 2005) (disgorgement extends only to the amount by which defendant profited; any further sum is a penalty); *SEC v. Willis*, 472 F. Supp. 1250, 1276 (D.D.C. 1978) ("When the amounts to be disgorged cannot be related with sufficient certitude to defendants' securities law violations, the SEC's disgorgement request takes on the character of a plea for punitive relief.").

When it suits its purposes, the SEC recognizes that disgorgement is a penalty. In *SEC v. Telsey*, 144 B.R. 563 (Bankr. S.D. Fla. 1992), the SEC successfully

argued that disgorgement was a penalty in seeking to exempt the ordered disgorgement from discharge under the bankruptcy code, which precludes discharge of a debt "to the extent such debt is for a *fine, penalty, or forfeiture*"— language identical to §2462. The bankruptcy court agreed with the SEC and found that the "purpose of the disgorgement order sufficiently penal to characterize the resulting debt as a 'fine, penalty, or forfeiture . . . .'" *Id.* at 565.

Disgorgement here is likewise a penalty because it does not remedy any damage caused to the allegedly harmed parties—New Forestry and AT&T. *Johnson*, 87 F.3d at 488. Instead, the ordered disgorgement would go only to the SEC. *See* 17 C.F.R. §§201.1100, 201.1102(b) (disgorgement goes to alleged victims only if monetary fines are imposed). Likewise, the disposition fee is not causally connected to any alleged wrongdoing. Timbervest earned its disposition fee as a percentage of the sales price. J.A.__[Div.Ex.47.p.6.] The SEC found that the sale of the Alabama Property violated the Advisers Act because Timbervest supposedly *undervalued* it when it sold the property. J.A.__[Opinion.8.] Under the SEC's theory, the sale would have still taken place, but the sales price should have been higher. But in that situation, Timbervest would have earned a *higher* disposition fee. Thus, Timbervest did not obtain any ill-gotten gains by supposedly undervaluing the property. *SEC v. Wyly*, 56 F. Supp. 3d 260, 271 (S.D.N.Y. 2014) ("Here,

the SEC's proposed disgorgement does not appear to arise from the violations and therefore smacks of punishment, not equity or deterrence.").

Moreover, the disgorgement order has been mooted, as demonstrated by a letter AT&T wrote to the SEC in which AT&T stated that Petitioners agreed to pay AT&T "in full and complete satisfaction of any claims that AT&T" may have against Petitioners, which included:

> *[A]ny claims* for any relief including interest or losses *relating to the $403,000 disposition fee that the [Petitioners] received in connection with the [Alabama P]roperty* and [the payment] *eliminates potential unjust enrichment* by the [Petitioners] . . . .

Exhibit 1 to Petitioners' Motion for Leave to Adduce Additional Evidence.

2. Disgorgement is a forfeiture.

Disgorgement is also a forfeiture barred by §2462. In *Riordan v. SEC*, 627 F.3d 1230 (D.C. Cir. 2010), this Court recognized that "[i]t could be argued that disgorgement is a kind of forfeiture covered by §2462, at least where the sanctioned party is disgorging profits not to make the wronged party whole, but to fill the Federal Government's coffers." *Id.* at 1234 n.1. Here, SEC rules prohibit the disgorgement imposed from compensating any alleged victims, and thus any disgorgement from Petitioners will go only to the government's coffers. 17 C.F.R. §§201.1100, 201.1102(b).

The most logical reading of the term "forfeiture" is that it must include disgorgement. *See, e.g.*, *United States v. Ursery*, 518 U.S. 267, 284 (1996) ("Civil forfeitures . . . are designed primarily to confiscate property used in violation of the law, and to require disgorgement of the fruits of illegal conduct."). Petitioners are aware of no Circuit that has held otherwise. Instead, courts have focused on the distinct question of whether disgorgement is a *penalty* under §2462. *See, e.g.*, *Johnson*, 87 F.3d at 491; *SEC v. Montle*, 65 F. App'x 749 (2d Cir. 2003). In *Riordan*, for example, this Court recognized that it had "not expressly considered" whether disgorgement is a forfeiture but determined that *Zacharias* "implicitly" rejected the argument. 627 F.3d at 1234 n.1. Contrary to the SEC's contention, *Riordan* did not "conclud[e] that disgorgement is not a forfeiture." J.A.__[Opinion.26, n.73.] Indeed, no party raised the issue of whether disgorgement is a forfeiture in either *Riordan* or *Zacharias*. Because any implicit reference to forfeiture was dicta, this Court is not foreclosed from considering the issue and clarifying that disgorgement is a forfeiture covered by §2462. *See, e.g.*, *Gersman v. Grp. Health Ass'n*, 975 F.2d 886, 897 (D.C. Cir. 1992) ("Binding circuit law comes only from the holdings of a prior panel, not from its dicta.").

C. The cease-and-desist orders sought and imposed by the SEC in this case are encompassed by §2462.

The cease-and-desist orders here are penal because they will substantially impair Petitioners from engaging in their profession. *See Bartek*, 484 F. App'x at

957 n.10 (sanctions that effectively "exclud[e] a person from their chosen profession" are penal); *SEC v. Jones*, 476 F. Supp. 2d 374, 384 (S.D.N.Y. 2007) ("[T]he requested injunction is not aimed at protecting the public from future harm, but more likely aimed at punishing Defendants.").

The collateral consequences of a cease-and-desist order "may be more devastating than a monetary fine" barred by §2462. Commissioner Luis Aguilar, Speech at Securities Enforcement Forum 2012: Taking a No-Nonsense Approach to Enforcing Federal Securities Laws (Oct. 18, 2012). For example, under the Dodd-Frank Act, individuals who have been ordered to cease and desist from violations of §206(1) of the Advisers Act are barred from participating in a Rule 506 offering for five years. 17 C.F.R. §230.506(d). Timbervest's funds are for fixed terms, and all its funds have been raised in reliance on the Rule 506 exemption. J.A.__[Transcript.1376-78.] If the cease-and-desist orders are upheld, Petitioners will be irreparably harmed because they cannot raise new funds for five years.

II. The administrative proceeding violated Petitioners' due process rights.

Beyond being subjected to an enforcement action that was brought outside the statute of limitations, Petitioners were also deprived of their due process rights.

A. The SEC's administrative process lacks impartiality and is biased in favor of the Commission.

The Due Process Clause entitles litigants to an impartial, neutral, and disinterested tribunal. *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 242 (1980). As this Court

has held, "an administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the *very appearance of complete fairness*." *Amos Treat & Co. v. SEC*, 306 F.2d 260, 267 (D.C. Cir. 1962) (emphasis added). This requirement "is applied more strictly in administrative proceedings than in court proceedings because of the absence of procedural safeguards normally available in judicial proceedings." *Ventura v. Shalala*, 55 F.3d 900, 902 (3d Cir. 1995) (citations omitted). Although ALJs are entitled to a presumption of impartiality, this presumption may be rebutted by "a history of ALJs ruling for the agency." *Rothenberg v. Daus*, 481 F. App'x 667, 676 (2d Cir. 2012).

1. The SEC's administrative process lacks the appearance of impartiality.

The SEC's administrative process suffers from the appearance of bias. The Commission files an OIP based on allegations presented to it *ex parte* by the Division of Enforcement ("Division"). The case is then assigned to an SEC ALJ who the SEC contends, contrary to Supreme Court authority, is an employee. Those SEC "employees" then rule on a case that the Commission decided to bring. Finally, the Commission itself can review its employees' rulings.

This structural bias is evidenced by the SEC's record of success in its own forum versus in federal court. During the 12 months ending September 2014, in *every* disputed administrative action, the SEC ALJs ruled in favor of the SEC. Jean

Eaglesham, *SEC Steering More Trials to Judges It Appoints*, THE WALL STREET JOURNAL ("WSJ"), Oct. 20, 2014. Yet during that same period, the SEC's winning percentage in federal court trials was 61%. *Id.* For the fiscal years 2012-14, the SEC had a success record in tried cases of 96% in its administrative forum versus 67% in federal court. *Id.*

The Division's success rate in front of ALJ Elliot is even more dramatic. As of February 2014, Judge Elliot had issued more than 50 initial decisions and had "yet to rule against the agency." Reuters, *SEC judge who took on the "Big Four" known for bold moves* (Feb. 3, 2014), http://www.reuters.com/article/us-sec-china-elliot-idUSBREA1107P20140203. At that time, in every case alleging a violation under §§206(1) and 206(2) of the Advisers Act, ALJ Elliot ruled in favor of the Division. *Id.*; J.A.__[2014.10.30.Timbervest.Appeal.p.33.] As of October 30, 2014, ALJ Elliot had still decided 100% of his cases in favor of the Division.

In its Opinion, the SEC dismissed Petitioners' argument that ALJs' history of ruling in favor of the agency supports a claim of bias, citing *Bunnell v. Barnhart*, 336 F.3d 1112, 1114 (9th Cir. 2003), for the proposition that the appearance of impropriety standard is not applicable to ALJs. J.A.__[Opinion.38-39 & n.126.] However, *Bunnell* is inapposite and dealt with the standard for *recusal* for ALJs, not whether due process requires the appearance of fairness in administrative proceedings. *See, e.g.*, *In re Murchison*, 349 U.S. 133, 136 (1955) ("justice must satis-

fy the appearance of justice"). Judge Elliot's history in front of the SEC is relevant and evidences the apparent bias of the SEC's administrative forum.

2. Petitioners presented actual evidence of SEC ALJ bias in favor of the SEC.

During the pendency of Petitioners' appeal to the Commission, the Wall Street Journal reported on serious allegations made by a former SEC ALJ regarding the fairness of the SEC's administrative process. J.A.__[2015.05.20-Motion.Additional.Evidence.Ex.1.]

Specifically the WSJ reported:

> Lillian McEwen, who was an SEC judge from 1995 to 2007, said she came under fire from [Chief ALJ] 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. . . .
>
> [T]he 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."

J.A.__[2015.05.20.Motion.Additional.Evidence.Ex.1.] The SEC denied Petitioners' request to conduct discovery on those charges but invited ALJ Elliot to file an affidavit addressing the allegations of bias in the administrative proceedings. J.A.__[2015.06.04.Order.p.2.] He declined to submit any statement and provided no reason for such refusal. J.A.__[2015.06.09.Response.Email.]

And even though the SEC asked its Inspector General ("OIG") to investigate, the SEC issued its decision in this matter before the OIG completed its investigation. The final OIG "Report of Investigation" ("Final OIG Report") confirms Petitioners' claims of bias and partiality. According to that report, two of the current ALJs admitted that there are "*systemic factors that impacted complete adjudicative independence*." Report of Investigation, Case # 15-ALJ-0482-I, at 2 (Jan. 21, 2016) (emphasis added), https://www.sec.gov/oig/reportspubs/Final-Report-of-Investigation.pdf. The Final OIG Report noted that, "when asked if they thought the system was slanted against defendants":

> Foelak, Patil, and [redacted name] identified possible systemic causes, including *de novo* review of decisions by the Commission, constraints due to "condition precedent" or legal rulings of the Commission, the rules of practice (which the SEC has recently proposed to amend), limited access by respondents to discovery and the investigative case file, and truncated timelines.

Id. at 20. Thus, two *current* ALJs, and another individual whose name is redacted, admit that there are aspects of the SEC's administrative process that affect adjudicative independence and fairness to respondents.

B. Petitioners' due process rights were violated when the SEC refused to order production of *Brady* material to Petitioners.

Under its own rules, the SEC is obligated to produce material exculpatory evidence, consistent with *Brady v. Maryland*, 373 U.S. 83, 87 (1963). 17 C.F.R. §201.130(b)(2). An agency's failure to comply with its own rules is a violation of

due process under *United States ex rel. Accardi v. Shaughnessy*, 347 U.S. 260 (1954). *See also Wilkinson v. Legal Servs. Corp.*, 27 F. Supp. 2d 32, 61 (D.D.C. 1998). A *Brady* violation occurs where: (1) the evidence at issue is favorable to the accused, either because it is exculpatory or impeaching; (2) it was suppressed; and (3) prejudice resulted from the suppression. *See Strickler v. Greene*, 527 U.S. 263, 281-82 (1999). To satisfy the prejudice component, the withheld evidence must be material. *United States v. Johnson*, 519 F.3d 478, 488 (D.C. Cir. 2008). Impeachment evidence is "especially likely" to be material if it concerns a key government witness. *United States v. Price*, 566 F.3d 900, 914 (9th Cir. 2009).

Although its rules required otherwise, the SEC produced no documents, notes, or emails that it identified as *Brady* material. However, prior to the evidentiary hearing in January 2014, the SEC produced emails that were filled with exculpatory information and inconsistent statements from the SEC's key witness (the "June 2012 emails"). These emails reflected statements made by Schwartz in interviews with the SEC in June 2012 and were key to the issue of Shapiro's disclosure to Schwartz of Boden's fee agreement. J.A.__[Stone.Decl.Ex.BB; 2013.11.25.Response.Motion.Compel.Ex.K.] These emails are exculpatory because they support Shapiro's account of the conversation—that he disclosed the fee agreement and that Schwartz consented to it—and contradict Schwartz's hearing

testimony. *Id*. The SEC claimed that it inadvertently produced the emails. J.A.__[2013.11.15.Motion.Protective.Order.]

The ALJ and SEC ruled that the June 2012 emails were not *Brady* material and prohibited Petitioners from using them. J.A.__[2013.11.25-Order; Opinion.32-33.] The June 2012 emails, however, constitute impeaching *Brady* material because they contradict Schwartz's hearing testimony on the issue of disclosure. *See United States v. Smith*, 77 F.3d 511, 515 (D.C. Cir. 1996) ("[T]he fact that other impeachment evidence was available to defense counsel does not render additional impeachment evidence immaterial.") (marks omitted).

The SEC's Opinion attempts to avoid the *Brady* issue by concluding that the fee arrangement between Boden and Timbervest never existed. But a significant piece of evidence that the fee arrangement did exist is Shapiro's and Schwartz's 2005 discussion about it, which is reflected in the June 2012 emails. It does not make sense that such a conversation would have occurred a year before the fees were paid if the fee arrangement was an after-the-fact concoction to justify the fees. Therefore, the June 2012 emails would have been important *Brady* material for the Petitioners to show that the fee arrangement did in fact exist. The SEC's effort to deem these emails immaterial because there was no such fee agreement is incorrect and circular.

III. The SEC's administrative proceeding violated Petitioners' right to equal protection.

Although the SEC has discretion to bring an enforcement action in federal court or its in-house forum, the SEC is still bound by the Equal Protection Clause when making that determination. *See Gupta v. SEC*, 796 F. Supp. 2d 503, 513 (S.D.N.Y. 2011) ("even if the SEC were acting within its discretion when it imposed disparate treatment on Gupta, that would not necessarily exculpate it from a claim of unequal protection if the unequal treatment was still arbitrary and irrational"). The SEC chose to bring this action in its administrative forum, depriving Petitioners of rights they otherwise would have been entitled to in federal court in violation of Petitioners' right to equal protection. The SEC has brought many federal court cases against investment advisors accused of fraud, *see, e.g.*, SEC's "Agency Financial Report," Fiscal Year 2015, Appendix B ("Major Enforcement Cases") at 154-56, *available at* www.sec.gov, but there are no statutory or regulatory provisions limiting or even explaining the SEC's choice of forum. The SEC cannot exercise its choice of forum—which profoundly affects the rights of the party the SEC sues—in an arbitrary and capricious manner.

An equal protection claim may be brought by a "class of one" where the aggrieved party "has been intentionally treated differently from others similarly situated and . . . there is no rational basis for the difference in treatment." *Vill. of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000). The Supreme Court has ruled that it

is a violation of the Equal Protection Clause for a state to afford some litigants a jury trial or other procedural protections while denying that right to similarly situated litigants. *See Baxstrom v. Herold*, 383 U.S. 107, 111 (1966) (a state, "having made this substantial review proceeding generally available on this issue, may not, consistent with the Equal Protection Clause of the Fourteenth Amendment, arbitrarily withhold it from some"); *Humphrey v. Cady*, 405 U.S. 504, 512 (1972) ("The equal protection claim would seem to be especially persuasive if . . . petitioner was deprived of a jury determination, or of other procedural protections, merely by the arbitrary decision of the State to seek his commitment under one statute rather than the other."); *Jackson v. Indiana*, 406 U.S. 715, 730 (1972) (violation of Equal Protection for the state to apply different commitment standards to persons who have criminal charges pending than for all others not charged with criminal offenses).

Based on these cases, it is a violation of the Equal Protection Clause for Petitioners to be arbitrarily treated differently from similarly situated SEC enforcement targets.

IV. SEC ALJs were not appointed in accordance with the Appointments Clause.

Under the Appointments Clause, principal officers must be nominated by the President and confirmed by the Senate, while inferior officers may be appointed by the President, a court of law, or a department head. U.S. Const. art. II, § 2, cl. 2;

Freytag v. Commissioner, 501 U.S. 868, 879-80 (1991). Employees, who are "lesser functionaries subordinate to officers of the United States," are outside the ambit of the Appointments Clause. *Buckley v. Valeo*, 424 U.S. 1, 126 n.162 (1976). The Appointments Clause reflects more than a "frivolous" concern for "etiquette or protocol," *Buckley*, 424 U.S. at 125, and instead concerns the separation of powers doctrine, *id.* at 272 (White, J., concurring); *Freytag*, 501 U.S. at 882. The Clause also "preserves another aspect of the Constitution's structural integrity by preventing the diffusion of the appointment power," so as to "ensure that those who wielded [that power] were accountable to political force and the will of the people." *Freytag*, 501 U.S. at 878, 884.

The SEC concedes that its ALJs are "not appointed by the President, the head of a department, or a court of law" but alleges that its ALJs are mere employees, rather than inferior officers. J.A.__[Opinion.41.] Every court to consider the issue has rejected that argument and concluded that SEC ALJs are inferior executive officers who have not been appointed under the Appointments Clause. *See Ironridge Glob. IV, Ltd. v. SEC*, No. 1:15-cv-2512, 2015 WL 7273262 (N.D. Ga. Nov. 17, 2015), *appeal docketed*, No. 16-10205 (11th Cir. Jan. 19, 2016); *Duka v. SEC*, 124 F. Supp. 3d 287 (S.D.N.Y.), *appeal docketed*, No. 15-2732 (2d Cir. Aug. 27, 2015); *Gray Fin. Grp., Inc. v. SEC*, 15-CV-492, 2015 WL 10579873 (N.D. Ga. Aug. 4, 2015), *appeal docketed*, No. 15-13738 (11th Cir. Aug. 20, 2015); *Timber-*

vest, LLC v. SEC, 1:15-cv-2106, 2015 WL7597428 (N.D. Ga. Aug. 4, 2015);[4] *Hill v. SEC*, 114 F. Supp. 3d 1297 (N.D. Ga.), *appeal docketed*, No. 15-12831 (11th Cir. June 25, 2015).

The remedy for this constitutional violation is to vacate the underlying proceedings because "[t]he alleged defect in the appointment . . . goes to the validity of the . . . [underlying] proceeding . . . ." *Freytag*, 501 U.S. at 879; *see also Ryder v. United States*, 515 U.S. 177, 182 (1995); *Intercollegiate Broad Sys., Inc. v. Copyright Royalty Bd.*, 684 F.3d 1332, 1334 (D.C. Cir. 2012); *Nguyen v. United States*, 539 U.S. 69, 80-81 (2003); *Landry v. FDIC*, 204 F. 3d 1125, 1130-32 (D.C. Cir. 2000).

A. SEC ALJs are inferior Officers.

"[A]ny appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States' . . . ." *Buckley*, 424 U.S. at 126. In distinguishing "inferior officers" from "principal officers" the Supreme Court has explained 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." *Edmond v. United States*, 520 U.S. 651, 663 (1997). The Supreme Court has held that the following are inferior officers—

- district-court clerks, *In re Hennen*, 38 U.S. (13 Pet.) 230, 258 (1839);

[4] This is an action brought by Timbervest seeking a limited injunction during the pendency of their appeal to the SEC.

- "thousands of clerks in the Departments of the Treasury, Interior and the othe[r]" departments, *United States v. Germaine*, 99 U.S. 508, 511 (1878); *Hennen*, 38 U.S. (13 Pet.) at 259;

- a clerk to an "assistant treasurer" stationed in Boston, *United States v. Hartwell*, 73 U.S. (6 Wall.) 385, 393-94 (1868);

- an "assistant-surgeon" and "cadet-engineer" appointed by the Secretary of the Navy, *United States v. Moore*, 95 U.S. 760, 762 (1878); *United States v. Perkins*, 116 U.S. 483, 484 (1886);

- election monitors, *Ex parte Siebold*, 100 U.S. 371, 397-99 (1880);

- federal marshals, *id.* at 397;

- "commissioners of the circuit courts" who "t[ook] bail for the appearance of persons charged with crime," *United States v. Allred*, 155 U.S. 591, 594 (1895);

- military judges, *Weiss v. United States*, 510 U.S. 163, 170 (1994); and

- the general counsel of the Department of Transportation, *Edmond v. United States*, 520 U.S. 651 (1997).

None of these inferior officers have the duties or discretion that an SEC ALJ enjoys. It is incomprehensible that an SEC ALJ is not an inferior officer, while all these other positions are.

In *Freytag*, the Supreme Court addressed whether a Special Trial Judge ("STJ") of the Tax Court was an "inferior Officer." 501 U.S. at 882. Although in certain cases the STJ could issue a final decision, that appeal involved a case in which the STJ could only "hear the case and prepare proposed findings" for which a regular judge of the Tax Court rendered the "actual decision." *Id.* at 873. As the

SEC does here, the government in *Freytag* argued that STJs were employees, not inferior officers, because the STJ lacked authority to enter a final decision in the matter before it. *Id.* at 881. The Supreme Court rejected the government's argument, stating that it "ignores the significance of the duties and discretion that special trial judges possess." *Id.* The Court found it significant that the STJ position was "established by Law" and "the duties, salary, and means of appointment for that office are specified by statute" because:

> 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.

Id. The Court further found that STJs "perform more than ministerial tasks" because "[t]hey take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders." *Id.* at 881-82. Only after holding that STJs were inferior officers because of their significant authority did the Court, as an alternative basis, find that the STJs' limited authority to issue final decisions also demonstrated that an STJ is an inferior officer. *Id.* at 882.

Like STJs, the position of an SEC ALJ is established by law, *see* 5 U.S.C. §556; 15 U.S.C. §78d-l, and the duties, salary, and means of appointment are specified by statute. *See* 5 U.S.C. §§556(c), 557 (responsibilities and powers of ALJs under Administrative Procedure Act ("APA")); *id.* §§5311, 5372 (salaries available

to ALJs); *id.* §3105 (creation of ALJ). Notably, SEC ALJs enjoy even greater tenure protection than STJs. Although STJs are appointed for an indeterminate period, they can be dismissed "without restriction." *First W. Gov't Sec., Inc. v. Commissioner*, 94 T.C. 549, 558 (1990). An SEC ALJ, however, receives a career appointment and can be dismissed by the SEC only upon a showing of "good cause," which must be "established and determined" by the Merit Systems Protection Board ("MSPB"). 5 U.S.C. §7521(a).

Both SEC ALJs and STJs are authorized to take sworn testimony and conduct trials. *See* 5 U.S.C. §§556(c)(1), (4); 17 C.F.R. §201.111. Both may rule on the admissibility of evidence. 17 C.F.R. §201.320. And both have the authority to oversee discovery efforts, *id.* §20 1.230, to issue, quash, or modify subpoenas, *id.*§201.232, and to oversee depositions, *id.* §201.233. In short, SEC ALJs are indistinguishable from STJs except that SEC ALJs are provided with greater tenure protection.

Nothing so well demonstrates that SEC ALJs are inferior officers than the fact that, in their absence, only a principal officer (*i.e.*, the Commission or Commissioners) can perform their functions. *See* 15 U.S.C §§77u, 80b-12 (requiring that SEC administrative hearings "be held before the Commission or an *officer* or *officers* of the Commission designated by it . . ."") (emphasis added); 17 C.F.R. §201.101(a)(5) ("*hearing officer* means an administrative law judge . . ."). Moreo-

ver, Congress specifically required that an SEC administrative hearing take place before an "officer." *See* 15 U.S.C. §§77u, 80b-12.

SEC ALJs also issue Initial Decisions "that include[] factual findings, legal conclusions, and, where appropriate, order[] relief." *See* www.sec.gov/alj. Relief may include cease-and-desist orders, suspensions, bars, disgorgement, and penalties. *Id*. Unlike the work of any mere employee of the Commission, an SEC ALJ's Initial Decision is issued and published on the SEC's website without any input from the Commission or its members. *Id.* Consistent with the APA, an SEC ALJ's decision becomes final if the parties do not petition the SEC for review. 5 U.S.C. §557(b); 15 U.S.C. §78d-1(c). Even if the parties petition for review, the Commission is not obligated to review every ALJ decision. 17 C.F.R. §201.360(d)(2). And in requesting a review of an ALJ's factual findings and conclusions of law, a party must show that the ALJ's findings were clearly erroneous. *Id.* §201.411(b).

B. The SEC's reliance on *Landry v. FDIC* is misplaced.

In *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000), this Court found that FDIC ALJs were not inferior officers. The SEC states that *Landry* "recognized that ALJs are different from" STJs. J.A.__[Opinion.44.] *Landry* made no such finding. As the DOJ stated in opposing Landry's petition for certiorari: "The court of appeals did not purport to establish any categorical rule that administrative law judges are employees rather than 'inferior Officers' for purposes of the Appointments

Clause." Br. In Opp. 7, *Landry v. FDIC*, No. 99-1916, 2000 WL 34013905, at *7 (U.S. Aug. 28, 2000). There, the DOJ was correct.

1. SEC ALJs are distinguishable from FDIC ALJs.

The SEC acknowledges differences between SEC ALJs and FDIC ALJs but dismissively claims that they are "superficial distinctions without substantive difference." J.A.__[Opinion.44.] These differences, however, are critical and were surely not meant to be "superficial" when Congress wrote them into the statute. They result directly from the SEC's election under the APA to use ALJs who issue "initial" rather than "recommended" decisions. *See* 5 U.S.C. § 557(b).

An SEC ALJ's initial decision, unlike an FDIC ALJ's recommended decision, can become final and is often never reviewed by the Commission. In contrast, an FDIC ALJ is required to issue a "recommended decision," not an "initial decision," and that recommendation along with the record of the proceeding must be reviewed in every instance by the FDIC's Board of Directors. 12 C.F.R. §308.38. The FDIC then renders its own final decision based on a review of the entire record. *Id.* §308.40. In stark contrast, SEC ALJs issue initial decisions that may (and usually do) become final decisions.

The SEC incorrectly claims that these differences are "merely differences in terminology, not substance" because its procedure of essentially rubber stamping an initial decision is supposedly akin to the FDIC Board issuing its own decision

J.A.__[Opinion.44.] To be sure, the Commission's Rules call for it to issue an order that the decision has become final *if* there is no appeal and the Commission chooses not to review an initial decision on its own initiative. 17 C.F.R. §201.360(d)(2). The plain language of the Securities Exchange Act, however, makes clear that the initial decision automatically becomes final when there is no appeal and no review by the Commission. 15 U.S.C. §78d-1(c) ("If the right to exercise such review is declined, or if no such review is sought . . . then the action of . . . [the ALJ] shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission."). The "order" prescribed in the SEC Rules of Practice does not make the initial decision a final decision—that happens by virtue of the statute. The Commission's Rule is simply a ministerial formality.[5]

As the SEC acknowledges, one substantive difference is that, unlike the FDIC, the SEC is not obligated to review all initial decisions by its ALJs. J.A.__[Opinion.44.] The SEC claims that this distinction is purely "on paper" because the Commission historically hears all petitions for review of initial decisions. J.A.__[Opinion.44.] Even assuming that assertion is true, it is constitutionally irrelevant because the SEC cannot say the same for all the other initial decisions where parties do not request review. The very fact that the SEC is not obligated to

[5] The SEC treats it as ministerial in many instances—in 2014 there were at least 174 cases where SEC ALJs' decisions became the final decision of the SEC. *See* J.A.__[2015.02.23.Br.p.15]; https://www.sec.gov/alj/aljdec/aljdecarchive/aljdecarc2014.shtml.

review every initial decision makes the authority of an SEC ALJ significantly greater than that of an FDIC ALJ. Even if the SEC's current policy is to hear all petitions for review, the SEC could change that policy at any time. The constitutional status of SEC ALJs cannot depend on discretionary policies that the Commission happens to have in place at a particular time.

Finally, the SEC's claim that it does not defer to its ALJs' findings but conducts a *de novo* review is inaccurate. J.A.__[Opinion.2.] The SEC is not required to and does not review every ALJ decision. In those cases, the SEC simply defers to its ALJ's findings. When the SEC does review its ALJ's initial decision, it gives "considerable weight and deference" to the ALJ's credibility determinations and rejects them only where "there is substantial evidence for doing so." *City of Miami, Florida*, 79 SEC Docket 2580, 2003 WL 1412636, at *1, n.4 (Mar. 21, 2003) (citations omitted). Even if the Commission itself were to reject a factual determination made by an ALJ, "a reviewing court generally *gives substantial deference to the factual findings of an ALJ*, [and] this deference is even greater when credibility determinations are involved." *Gimbel v. Commodity Futures Trading Comm'n*, 872 F.2d 196, 199 (7th Cir. 1989) (emphasis added). Thus, even an Article III court gives deference to an ALJ's finding—no other SEC "employee" is given such deference.

2. The SEC's overly-broad reading of *Landry* conflicts with Supreme Court precedent.

The SEC's position that an inferior officer must have authority to issue final decisions is in direct conflict with Supreme Court precedent. J.A.__[Opinion.41.] In *Freytag*, the Court rejected this same argument, finding that the government "ignores the significance of the duties and discretion that [STJs] possess." 501 U.S. at 881. The authority of STJs in *Freytag* to issue final orders was merely an additional reason, not *the* reason, the Court found STJs to be inferior officers. *Ironridge*, 2015 WL 7273262, at *38-*39.

The Supreme Court has held that an inferior officer, by definition, is one "whose work is directed and supervised at some level by others who were appointed by Presidential nomination." *Edmond*, 520 U.S. at 663; *see also Ryder v. United States*, 515 U.S. 177, 182-83 (1995) (finding judges of the Court of Military Review inferior officers, even though their decisions were reviewed by the Court of Military Review). As Justice Alito recently stated, "[i]nferior officers can do many things, but nothing final should appear in the Federal Register unless a Presidential appointee has at least signed off on it . . . ."[6] *Dep't of Transp. v. Ass'n of Am. R.R.*, 135 S. Ct. 1225, 1239 (2015) (Alito, J., concurring).

[6] This is consistent with DOJ's Office of Legal Counsel's guidance that "[a]n ALJ whose decision could not be reviewed by the Secretary, however, would appear to be acting as a principal officer of the United States." 15 U.S. Op. Off. Legal Counsel 8, 1991 WL 499882, at *5 (O.L.C. Jan. 31, 1991); *see also* Memorandum Opin-

This Court's decision in *Tucker v. Commissioner*, 676 F.3d 1129 (D.C. Cir. 2012), is instructive. There, this Court stated that "the main criteria for drawing the line between inferior Officers and employees not covered by the [Appointments] clause are (1) the significance of the matters resolved by the officials, (2) the discretion they exercise in reaching their decisions, and (3) the finality of those decisions." *Id.* at 1133. This Court found that certain officials who oversee tax liens at the IRS Office of Appeals were not inferior officers for Appointments Clause purposes because, among other things, they were "subject to consultation requirements." *Id.* In distinguishing IRS Appeals employees from the STJs in *Freytag* who conduct trials, this Court stated that the Office of Appeals "does not hold trials at all." *Id.* at 1135. Further, the Court found that IRS Appeals proceedings "are informal and testimony under oath is not taken" and that "the Court in *Freytag* may have taken the presence of those procedures as a signal from Congress of the weightiness of the substantive powers granted." *Id.* Here, SEC ALJs' authority is akin to STJs who are inferior officers and bear little to no resemblance to an IRS Appeals employee.

Moreover, because of their tenure protection and the authority exercised, if SEC ALJs could issue final decisions, they would be principal officers. This Court

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ion for the General Counsels of the Executive Branch, 31 Op. O.L.C. 1 (2007) (advising that "independent discretion" is not a necessary attribute of inferior officers).

made such a finding in *Intercollegiate Broadcasting System*, as to Copyright Royalty Board Judges ("CRJs") who could set the terms and conditions of copyright rates. Because they could issue final decisions "subject to reversal or change only when challenged in an Article III court" and because they can be removed only for misconduct, they were principal officers. 684 F.3d at 1340. Similarly here, if SEC ALJs could issue final decisions, their decisions would be subject to reversal or change only in an Article III court, making them principal officers. The SEC's overbroad reading of *Landry* would lead to the odd result that by issuing final decisions, SEC ALJs would be principal officers, but because they do not issue "final" decisions, they somehow are not even inferior officers.

V. The SEC's administrative proceeding violates the separation of powers.

In *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010), the Supreme Court held that 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.* at 514. The SEC ALJ position violates this bright-line rule because SEC ALJs are inferior executive officers who are provided with two layers of good-cause tenure protection. They are appointed for life and are removable only for "good cause," which must be established by the MSPB. 5 U.S.C. §7521(a). Further, the SEC Commissioners who exercise the power of removal, and the members of the MSPB who determine whether sufficient "good cause" ex-

ists to remove an SEC ALJ, can be removed by the President only for "inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. §1202(d).

The SEC states that the nature of an SEC ALJ's duties differ from the PCAOB's duties because ALJs perform adjudicative, rather than enforcement or policy-making functions. J.A.__[Opinion.48.] The Supreme Court, in *Morrison v. Olson*, 487 U.S. 654 (1988), however, rejected a similar theory that the President's removal authority operates less stringently for quasi-judicial and quasi-legislative officers than for officers with "purely executive" functions. *See id.* at 689 ("[T]he President's power to remove an official cannot be made to turn on whether or not that official is classified as 'purely executive.'"). It follows that Congress may not create a class of executive adjudicators operating outside the constraints of executive authority over other Commission officers.

VI. The SEC's finding of liability is not supported by substantial evidence.

The SEC erred in finding that Timbervest violated §206(1)-(2) of the Advisers Act and in finding that the Partners aided, abetted, and caused Timbervest's violations. Subsections 206(1) and (2) make it unlawful for an investment adviser to use interstate commerce "to employ any device, scheme, or artifice to defraud" a client or "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." 15 U.S.C. §§80b–6(1) and (2).

The SEC must prove that Timbervest acted negligently under §206(2) and with scienter under §206(1). *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963); *Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 677-78 (11th Cir. 1988). For its claims under §206(1), the SEC must establish that Timbervest acted with an "intent to deceive, manipulate, or defraud." *Aaron v. SEC*, 446 U.S. 680, 686 (1980).

A. There was no material omission or misstatement.

The SEC was required to show that Petitioners made a material omission or misstatement. *See, e.g.*, *Vernazza v. SEC*, 327 F.3d 851, 858 (9th Cir. 2003); *SEC v. Pimco Advisers Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 470 (S.D.N.Y. 2004). It did neither.

1. Boden was paid under a disclosed consulting agreement.

The SEC found that Timbervest violated the Advisers Act because Boden had never entered into a five-year advisory fee agreement and therefore Timbervest "violated its fiduciary obligations of good faith and full and fair disclosure of material facts by concocting the claims about the oral agreement . . . ." J.A.__[Opinion.16.] This finding is directly contrary to the ALJ's finding that the fee agreement existed. J.A.__[ID.48.]

The finding is also contradicted by the evidence that there was, in fact, a fee arrangement under which Boden was paid. There is no dispute that Shapiro and

Schwartz had a conversation about the fee arrangement in 2005—well before any fees were paid to Boden.[7] J.A.__[Transcript.1778-79, 2057.] While there is a dispute about what exactly was said during this conversation—because no one was asked about it until seven years later—there is no doubt that the conversation occurred. It is illogical to think that Shapiro and Schwartz had a conversation about a fee agreement that did not exist.

Moreover, there is no doubt that Boden came to work for Timbervest in 2002—when his fee agreement began. J.A.__[Transcript.70-71.] And there is no doubt that Boden received no compensation from Timbervest until 2004 when he became a partner. J.A.__[Transcript.91, 412-13.] It defies logic that, as a consultant, Boden would work unpaid without some agreement for future payment.

Additionally, a draft contract for the sale of the Rocky Fork property demonstrates that the fee agreement existed. J.A.__[Div.Ex.39.] The unconsummated contract for the sale of that property, anticipated to close before the end of 2007, provided for Boden's advisory fee in accordance with the terms of his agreement. J.A.__[Div.Ex.39; Transcript.445-46.] When Timbervest eventually contracted to sell the property to another buyer, the closing date was scheduled to be in 2008—outside the 2007 sunset date of Boden's fee agreement. J.A.__[Div.Ex.43; Transcript.447-48.] Boden's advisory fee was therefore never included in the final con-

[7] Additionally, the *Brady* material set forth in the June 2012 emails confirms that Shapiro told Schwartz about Boden's fee agreement. *Supra* PartII.B.

tract, and Boden received no fee on the sale of the property. J.A.__[Div.Ex.43; Transcript.447-49.] This evidence shows that not only did Boden's fee arrangement exist, but the terms of the arrangement were defined and adhered to.

The SEC, however, disagreed with the ALJ's finding and found instead that Boden's fee agreement never existed. J.A.__[Opinion.16.] The SEC first argues that the fee agreement did not exist because it was not put in writing. J.A.__[Opinion.17.] But there is no law requiring that such an agreement be put in writing. Oral agreements regarding employment and consulting fees were common. In fact, *none* of the Partners had written employment agreements when they came to Timbervest, and other similar commission agreements between Timbervest and brokers were oral. J.A.__[Div.Ex.152; Transcript.1768, 1950.]

The SEC next contends that the fee agreement did not exist because it was entered into when Shapiro was in a "trial period" with Timbervest. J.A.__[Opinion.17.] But Shapiro joined as CEO, and the "trial period" was simply for him to determine whether Timbervest was a viable business. J.A.__[Transcript.1700.] Despite being in a "trial period," Shapiro was "given full authority" under New Forestry's sell-down mandate. J.A.__[Transcript.1697, 1737-38.]

The SEC also complains that BellSouth's sell-down mandate required selling only $30 to $60 million in property, while Boden's fee agreement covered

properties with a combined value of $144 million. J.A.__[Opinion.17.] As Shapiro explained, however, it takes a significant amount of time to sell timberland at the proper value. J.A.__[Transcript.1743.] At the time, Timbervest "had horrible maps, no knowledge of real estate markets, [and] quite frankly, they didn't really know what they had." J.A.__[Transcript.1743.] It would take time to get the properties in a state where they were ready to be sold, and there was no guarantee or expectation that all eight properties would be sold. J.A.__[Transcript.1743.][8] In fact, only two of the eight covered properties sold during the five-year term of the agreement.

Finally, the SEC determined that Boden's fee agreement did not exist because Jerry Barag, a Timbervest partner from 2003 and 2004, did not recall it. J.A.__[Opinion.18.] But the agreement was entered into *12 years* prior to Barag's testimony, so it is no surprise that he did not recall it. Indeed, at the hearing, Barag could not correctly recall his own compensation at Timbervest, the owners of Timbervest, the identities of Timbervest's clients, or the status of himself or other individuals as employees or owners of Timbervest.[9] And Barag, by his own admission,

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[8] Relatedly, the SEC argues that because Boden made no sales for the first four years of his fee agreement, it must not have existed. J.A.__[Opinion.17.] But, again, it takes a significant amount of time to sell timberland, particularly given the state of the properties when Boden and Shapiro joined Timbervest. J.A.__[Transcript.1743.] Additionally, beginning in 2004, the Partners primarily worked on raising funds for TVP and on the effort to take Timbervest public as a Real Estate Investment Trust. J.A.__[Transcript.74, 81-82.]

[9] For example, Barag testified that he was a Timbervest employee and earned a salary of $100,000. J.A.__[Transcript.1975–76.] Barag was never a Timbervest

had very little to do with the New Forestry account while at Timbervest. J.A.__[Transcript.1924, 1949.]

The SEC's finding that Boden's fee agreement did not exist is not supported by substantial evidence.

2. There was no parking arrangement, cross trade, or sale-and-repurchase agreement.

The SEC has had an ever-shifting theory of liability with respect to the Chen Transactions. First, the OIP alleged that the Chen Transactions were a "parking arrangement." J.A.__[OIP.] The Petitioners established that the transactions did not meet the definition of a parking arrangement because Timbervest did not retain any risk after selling the Alabama Property to Chen. J.A.__[Motion.Summary-Disposition.6-7.] The SEC then argued, in post-hearing briefing, that the Chen Transactions were a "cross trade." J.A.__[Div.Post-Hearing.Brief.11-14.] Again, the Petitioners established that the two transactions were not a cross trade because the Alabama Property was not sold directly from one fund to another. J.A.__[2014.04.18-Timbervest.Response.to.Division.Post-Hearing.Brief.27-28.]

Recognizing the fatal flaws in these two theories, ALJ Elliot, without briefing or argument from the SEC, found that Timbervest failed to disclose a "verbal

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employee, and he received a draw of more than $200,000 per year. J.A.__[Transcript.2244; Resp.Ex.149.] Barag denied that he had an equity interest in Timbervest in 2004, but he was an owner of Ironwood Capital Partners, which owned 20% of Timbervest at the time. J.A.__[Transcript.1995.]

option" that Boden had received from Wooddall to repurchase the Alabama Property. J.A.__[ID.44.] The SEC seemingly agreed by finding a violation because Wooddall "had secretly agreed to sell [the property] back to Timbervest shortly thereafter." J.A.__[Opinion.8.]

But the only evidence to support this finding is Wooddall's shifting testimony that he gave a "verbal option" to Boden. The documentary evidence makes no mention of a "verbal option." Instead, the contract states that "Purchaser's agreement to enter into the agreement is not contingent upon any other agreement or understanding," and Wooddall testified that he believed this language to be true. J.A.__[Div.Ex.11.p.963342; Transcript.863.] Wooddall also testified that he "was free to sell the property to anybody else" and would have done so at the right price. J.A.__[Transcript.768-69.] The SEC's finding that there was a purchase-and-sale agreement was in error because it is not supported by the evidence. Instead, the evidence shows that the reason for TVP's purchase and the higher price was that the value of the property increased substantially. *Supra* PartII.C.

The SEC's theory would mean that Petitioners agreed to pay Wooddall over $1 million simply to hold the property—more than Petitioners themselves received from the disposition of the property. But the SEC never charged Wooddall, nor has it ever sought to disgorge this $1 million from Wooddall. There is no substantial evidence to support such an implausible theory of liability.

B. There was insufficient evidence of scienter.

As discussed below, the SEC erred in finding that Timbervest acted with scienter. *Infra* PartVII.A.1. Because there was no material misstatement or omission and because Timbervest did not act with scienter, the SEC's finding of liability under §206(1) of the Advisers Act was arbitrary and capricious and should be vacated.

VII. The SEC's imposition of sanctions is unwarranted.

Finally, this Court should vacate the SEC's imposition of sanctions because it was arbitrary, capricious, and not supported by substantial evidence.

A. The factors the SEC used do not support the imposition of associational bars or cease-and-desist orders.

The SEC imposed associational bars and cease-and-desist orders after purporting to apply the factors in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979):

> [T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

None of these factors support the career-ending sanctions on Petitioners here.

1. Any violations were not egregious and did not involve a high level of scienter.

The SEC erred in finding that the egregiousness and scienter factors weighed in favor of imposing associational bars and cease-and-desist orders.

a. Any violation arising from Boden's receipt of fees was not egregious or undertaken with scienter.

The SEC incorrectly determined that Petitioners' violations were egregious and undertaken with scienter with respect to Boden's fees because of the use of LLCs and cashier's checks and the sharing of the fees among the Partners. J.A.__[Opinion.27.]

Boden sought the advice of counsel to protect his assets from the claims of other brokers, and *his attorney advised* him to use LLCs, which are a common asset-protection vehicle. J.A.__[Transcript.589-93.] The other Partners had no knowledge of the LLCs. J.A.__[Transcript.1303-05, 1568-69, 1826-27.] Likewise, Boden independently decided to share the fees after considering his business relationship with the Partners. J.A.__[Transcript.288-93.] The other partners first learned that Boden would share his fees when he delivered cashier's checks to them. J.A.__[1312-13, 1346, 1557, 1572-73, 1827-28.]

Not only are the SEC's findings of egregiousness unsupported, but the SEC ignored compelling evidence that the Partners acted with good faith. As noted, Boden sought advice from counsel as to how to receive the fee.

J.A.__[Transcript.369.] Shapiro voluntarily disclosed the fee arrangement to Schwartz. J.A.__[Transcript.1756, 1774, 1776-77, 2249.] Boden, Jones, and Zell understood that Shapiro had disclosed the fee arrangement to Schwartz and that Schwartz had provided his consent. J.A.__[Transcript.1325, 1331, 1337, 1352, 1469, 1541 1789-90.] Notably, even ALJ Elliot found that Jones and Zell did not act with scienter or recklessly with respect to Boden's fees because they subjectively believed that Shapiro had effectively disclosed the fee arrangement to ORG—BellSouth's investment manager.[10] J.A.__[ID.53-54.] Boden, Jones, and Zell were entitled to rely on Shapiro's representations that he had disclosed the fee arrangement and received consent from Schwartz, and thus, they did not act with scienter. J.A.__[ID.53-54.]

b. Petitioners did not act with scienter or egregiously when they approved two transactions that benefitted their clients.

The SEC's conclusion that the Petitioners acted egregiously and with scienter regarding the Chen Transactions is also unwarranted. The SEC claims that as members of Timbervest's Investment Committee, the Partners "falsely lowered [the Alabama Property's] valuation before the sale to Chen Timber and changed

[10] Boden testified that he believed that Shapiro had effectively disclosed the fee arrangement to Schwartz, but ALJ Elliot failed to consider this point. J.A.__[Transcript.414.]

the property's name after the repurchase in an effort to cover up the transaction." J.A.__[Opinion.27.]

Contrary to the SEC's unsupported findings, being a member of Timbervest's Investment Committee does not equate with involvement in negotiations with Wooddall. Indeed, Jones, Shapiro, and Zell testified that they were not involved in any negotiations regarding the Alabama Property or in any conversations with Wooddall, and the SEC offered no contrary evidence. J.A.__[Transcript.122-23, 1478-79, 1553, 1640, 1648, 2255-56.] Nor was there anything on the face of the transactions that suggests impropriety. The Investment Committee evaluated the two deals separately at separate times—nearly seven months apart—and ultimately determined that each transaction was good for the client. J.A.__[Transcript-856, 1422-24.]

Second, the Alabama Property was not undervalued—the evidence showed that it sold at a price above its value. The sale price was 11% higher than the most recent third-party appraisal. J.A.__[Resp.Ex.52; Tr.203-07, 209-10, 1661.] And, as of the closing date, the sales price exceeded its booked value by 11.7%. J.A.__[Transcript.206.] Even Wooddall, the SEC's *only* witness on the Chen Transactions, testified that the price was fair and not an undervaluation of the property. J.A.__[Transcript.772.]

Timbervest's valuation of the Alabama Property was based on objective, market-based evidence and was in accordance with Timbervest's valuation policy, which New Forestry and its beneficial owners understood and approved and which the SEC had investigated for three years without bringing charges. J.A.__[Transcript.1173, 1281, 1464.] There was no argument that Timbervest misapplied its valuation policy to the Alabama Property. Nor was there any testimony that the Alabama Property was undervalued. The SEC has failed to point to *any evidence* that undercuts the objective evidence of the Alabama Property's valuation.

Instead, the SEC found that Timbervest undervalued the Alabama Property because of (1) a lender-ordered appraisal neither Petitioners nor Wooddall ever saw, (2) sales of properties that had not taken place yet, and (3) a prior estimate of the prices expected to be received on different properties. J.A.__[Opinion.8-10.] A lender appraisal that was never given to Wooddall or Petitioners cannot reasonably form the basis of a finding that Timbervest undervalued the Alabama Property—let alone that Petitioners acted with scienter or egregiously. J.A.__[Div.Ex.57; Transcript.855.] Likewise, the SEC contends that the Partners were "already aware" of strong prices of nearby properties, but these properties did not go under contract until nearly *one month after* the sale of the Alabama Property closed. J.A.__[Resp.Ex.125.] Finally, the SEC contends that Petitioners undervalued the Alabama Property because a Timbervest report to New Forestry estimated that

nearby tracts would be sold at prices close to their ultimate sales price. J.A.__[Opinion.9, n.22.] But the report did not estimate prices based on actual sales or guaranteed prices. J.A.__[Div.Ex.16.] It reflected the prices that Timbervest hoped to get for properties that were in geographic proximity to the Alabama Property but substantially different in size and characteristics. J.A.__[Div.Ex.7.p.18987; Transcript.109.] The SEC's reliance on an estimated sales price to show that the Alabama Property was undervalued was in error. Most importantly, the SEC's erroneous conclusions ignore the uncontroverted fact that the value of the timber on the property increased by approximately $1 million (15%). J.A.__[Transcript.200-01, 553.]

Moreover, the SEC's contention that Timbervest internally changed the name of the Alabama Property from Tenneco to Gilliam Forest upon TVP's purchase to hide the transaction is pure conjecture, not supported by any testimony or any evidence. The SEC ignored uncontroverted testimony establishing that Timbervest changed the name for recordkeeping purposes only, as a way to keep tax and property records separate because New Forestry continued to own land under the name "Tenneco." J.A.__[Transcript.110-11, 185, 243.]

The SEC also contends that Petitioners acted egregiously and with scienter because they obtained a benefit from TVP's purchase of the Alabama Property, but

there was no evidence presented about the nature or extent of any benefit obtained. J.A.__[Opinion.27.]

c. There is no evidence of any pattern of unlawful transactions.

Finally, the SEC contends that Petitioners' alleged "violations were part of a pattern of several unlawful transactions and two similar attempted transactions." J.A.__[Opinion.27.] The SEC first points to the draft sales contract for the Rocky Fork property, which contract originally provided for a fee to Boden in accordance with his advisory agreement. J.A.__[Div.Ex.39.¶11.3; Div.Ex.127.p.2; Transcript.393-94.] That agreement fell through. J.A.__[Transcript.350.] When Timbervest eventually contracted to sell the property, the sale no longer met the parameters of Boden's fee agreement, and no fee was specified in the contract or given. J.A.__[Div.Ex.43.] Boden did not receive a consulting fee on the sale of the Rocky Fork property. J.A.__[Transcript-447-49.] The Rocky Fork agreements do nothing but support that Boden's consulting fee existed.

The SEC also contends that the Petitioners attempted a similar resale agreement on the Glawson property. But Reid Hailey, the SEC's only witness on this point, did not recall any specific negotiations on the proposed transaction and only "assumed" that "whoever owned the property . . . wanted to sell it and then sometime later they wanted to buy it back." J.A.__[Transcript.872.] Hailey's vague rec-

ollection of a single conversation from 2005 is not enough to support the theory that this unconsummated deal would have been improper.[11]

Further, Hailey's testimony was unreliable. He told the Partners' counsel that his testimony at the evidentiary hearing "would go much more favorable" for the Petitioners if Boden, Shapiro, and Zell made an additional investment into an unrelated (and subsequently foreclosed upon) financial venture sponsored by Hailey. J.A.__[Transcript.889-90.] The Partners' decision not to make the additional investment harmed Hailey personally, and he was motivated to provide unhelpful testimony against them. J.A.__[Transcript.891.]

2. Petitioners have provided adequate assurances against future violations.

The SEC found that the Petitioners had not provided adequate assurances against future violations because they continue to argue that they did not violate the Advisers Act. J.A.__[Opinion.28.] Under this bootstrapping view, only a respondent who does not contest the charges against him could provide adequate assurances.

Contrary to the SEC's finding, Petitioners acknowledged that they should have done a better job documenting Boden's fee agreement and describing the

[11] Moreover, there was no finding or evidence that Jones, Shapiro, or Zell were even remotely involved in the attempt to sell the Glawson property in 2005, but the SEC improperly uses the negotiations between Boden and Reid Hailey as a reason to impose associational bars and cease-and-desist orders on *all* Petitioners.

Chen Transactions. J.A.__[Transcript.1274, 1319, 1327, 1337, 1768.] And more importantly, they voluntarily repaid Boden's fees, with interest, to AT&T even before the SEC filed charges. J.A.__[Div.Ex.130.] There is no reasonable likelihood of any future violations, and the SEC's findings are not supported by substantial evidence.

3. Petitioners pose no risk to the investing public.

The SEC's finding that Petitioners pose a risk to the investing public is contradicted by the SEC's delay in bringing charges, failure to seek emergency relief, request to postpone the hearing, granting ALJ Elliot additional time to prepare an initial decision, and voluntary stay of its own relief. The SEC took all these actions despite the fact that Petitioners "continue to interact with the investing public and directly control hundreds of millions of dollars [sic] worth of clients' money." J.A.__[Opinion.28.]

Despite the obvious conclusion based on the SEC's conduct that Petitioners pose no realistic threat to investors, the Commission found that this factor weighed in favor of harsh sanctions because of: (1) two letters that Timbervest's in-house counsel wrote to AT&T, and (2) Petitioners' management and development of the Glawson Property in 2008 and 2009. J.A.__[Opinion.28-29.] These allegations are unsupported.

a. Two letters sent to a single Timbervest client that set forth Petitioners' arguments for litigation do not show any risk to the public.

The SEC points to two letters from Timbervest's in-house counsel to AT&T about the SEC's investigation as a basis for finding that Petitioners pose a risk to the investing public. J.A.__[Opinion.28.] The SEC found that a June 8, 2012 letter "falsely claim[ed] that the brokerage commissions were paid to Boden under a preexisting arrangement; the letter also omitted any mention of the fact that the commissions were paid to shell entities." J.A.__[Opinion.28, n.84.]

The June 8 letter's description of Boden's fee arrangement was accurate because Boden's fees were, in fact, paid in accordance with a preexisting fee arrangement. *Supra* PartVI.A.1. And while the June 8 letter did not mention that Boden's fees were paid to LLCs rather than directly to Boden, it did not need to. Petitioners had exchanged letters with AT&T in the two weeks prior to June 8, 2012, in which they specifically discussed that Boden received his fees through two LLCs in which he had a beneficial interest and that he later decided to share the fees with the Partners. J.A.__[Div.Ex.126; Div.Ex.127.] The June 8 letter was explicitly a follow-up to these earlier letters, and there was no need to provide information that AT&T already had.

The SEC also points to an August 3, 2012 letter from Timbervest's in-house counsel that supposedly "falsely described the [Alabama Property] sale and repur-

chase as independent transactions that were entered into separately." J.A.__[Opinion.28, n.84.] The letter did state that the two transactions were independent and that there was no prearranged sale-and-repurchase agreement. J.A.__[Div.Ex.128.] As discussed above, that was accurate. *Supra* PartVI.A.2. At a minimum, this was Petitioners' honestly-held belief based on their recollection of six-year-old events. Denying the SEC's allegations and publically communicating that denial does not demonstrate a risk of harm to the public. Under the SEC's theory, *any* defendant that denies charges brought by the SEC poses a risk of harm to the public, even in the absence of any ongoing or future risk of harm.

b. Petitioners' management of the Glawson property does not show a risk to the public.

It was also error for the SEC to find that Petitioners represent a risk to investors because of their management of the Glawson property. J.A.__[Opinion.28-29.] The SEC did not bring any charges with respect to Glawson. As further evidence of the unfairness of the SEC's administrative process, Petitioners were forced to defend themselves regarding their management of Glawson, even though the SEC never alleged any improper management of the property in the OIP.

Even if Petitioners' management of Glawson were relevant to determining whether they are a threat to investors, the SEC's finding was erroneous. The SEC's complaints arise only from the Partners' development of the property in an effort to add value to it. J.A.__[Opinion.29, n.85; Transcript.1871-72, 1879-80.] The SEC

complains that Timbervest cancelled a revenue-generating hunting lease and supposedly gave a free lease to a "hunt club" instead. J.A.__[Opinion, n.85.] But undisputed evidence shows that the "hunt club" was put in place for insurance purposes only. J.A.__[Opinion.29, n.85; Transcript.1897-99.] Timbervest cancelled a revenue-generating lease to improve the property and avoid injuries while implementing the improvements. J.A.__[Transcript.1882.] As Shapiro explained, "[i]f you have hunters on there, you're going to decimate the wildlife population," and when working on property improvements "the last thing you want out there are people with guns . . . ." J.A.__[Transcript.1869, 1883.] Moreover, the hunting lease income of $5,000 to $6,000 per year was an immaterial amount for New Forestry. J.A.__[Transcript.1882.] The development of the property as a hunting preserve, in contrast, added two or three *million* dollars in value. J.A.__[Transcript.1870.]

The SEC also complains that Timbervest held annual dove hunts and conducted timber tours on the property. J.A.__[Opinion.29, n.85.] But the dove hunts were an attempt to provide exposure to the property. J.A.__[Transcript.1903-04.] They were never hidden from BellSouth or AT&T. Indeed, PricewaterhouseCoopers, New Forestry's auditor, knew about the dove hunts and provided guidance on the best way to account for them. J.A.__[Div.Ex.168; Transcript.2263-65.] Had Timbervest intended to hide this information from the client, it never would have shared it with the client's auditor.

Likewise, the timber tours were never hidden from BellSouth or AT&T. In fact, Timbervest invited AT&T personnel on many timber tours. J.A.__[Transcript.1874-75.] Timbervest conducts tours on properties owned by all of Timbervest's funds, as they are the only way that Timbervest can showcase its investment manager services. J.A.__[Transcript.1871-72, 1881.]

All the improvements Timbervest made to the Glawson property were made to benefit the property and New Forestry's portfolio. They substantially increased the property's value, were permitted, and even encouraged, under the investment guidelines, and followed a well-conceived management plan to provide New Forestry with a profitable exit strategy for the property. J.A.__[Div.Ex.47; Transcript.1870, 1879-80.] The SEC ignored all this evidence.

4. The SEC failed to consider the isolated nature of the violations.

The SEC purported to weigh the *Steadman* factors in determining the propriety of associational bars and cease-and-desist orders. J.A.__[Opinion.26-27.] Among the *Steadman* factors is "the isolated or recurrent nature of the infraction." *Steadman*, 603 F.2d at 1140. The SEC completely failed to address this factor.

The reason for this omission is clear: any violations were extremely isolated in nature. The SEC brought charges for and found only two violations, which, at this point, took place nearly a decade ago. There have been no allegations and no charges of any violations since.

B. Disgorgement was not causally related to any misconduct.

Finally, the SEC ordered Petitioners to disgorge the disposition fee that they received on the sale of the Alabama Property. J.A.__[Opinion.31.]

Disgorgement is supposed to be an equitable remedy designed to prevent defendants from profiting from illegal activity. *See, e.g.*, *Zacharias*, 569 F.3d at 472. Its primary purpose is to correct unjust enrichment and restore the parties to the status quo ante. *Id.* at 471; *SEC v. AbsoluteFuture.com*, 393 F.3d 94, 96 (2d Cir. 2004). Disgorgement therefore must be causally related to wrongdoing. *Zacharias*, 569 F.3d at 472.

Here, as discussed above, there is no causal connection between the disposition fee and any misconduct, and any alleged unjust enrichment has already been repaid to AT&T. *Supra* PartI.B.1. The SEC's imposition of disgorgement was therefore arbitrary and capricious.

CONCLUSION

The Court should vacate the Commission's Order and Opinion for the reasons set forth above.

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume requirement of Federal Rule of Appellate Procedure 32(a)(7) because this brief contains 13,979 words, as determined by the word-count function of Microsoft Word 2010, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii); and

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Dated: April 22, 2016

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CERTIFICATE OF SERVICE

I hereby certify that, on this 22nd day of April, 2016, I electronically filed the foregoing Opening Brief for Petitioners with the Clerk for the United States Court of Appeals for the District of Columbia Circuit using the appellate CM/ECF system. Service was accomplished by the CM/ECF system on the following counsel, who are registered CM/ECF users:

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