UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

BARBARA DUKA,	
Plaintiff,	
v.	
U.S. SECURITIES AND EXCHANGE COMMISSION,	
Defendant.	

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF BARBARA DUKA'S MOTION FOR A PRELIMINARY INJUNCTION AND IN OPPOSITION TO THE SECURITIES AND EXCHANGE COMMISSION'S MOTION TO DISMISS THE AMENDED COMPLAINT

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Dated: July 15, 2015

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Plaintiff Barbara Duka respectfully submits this Memorandum of Law in opposition to the motion of the U.S. Securities and Exchange Commission ("SEC") to dismiss the Amended Complaint, Dkt. No. 47, and in further support of her application to enjoin the SEC from continuing to prosecute the administrative proceeding captioned, *In the Matter of Barbara Duka*, Admin. Proc. File No. 3-16349 (Jan. 21, 2015) (the "AP").[1]

PRELIMINARY STATEMENT

Prior to the filing of the Motion to Dismiss, the parties had submitted two rounds of briefing addressing substantially all of the legal issues presented by both the SEC's motion to dismiss and Ms. Duka's motion for an injunction, and this brief accordingly incorporates by reference all of Ms. Duka's submissions to date. By way of procedural update, since the last conference in this matter, the ALJ has denied an application for ten-week adjournment, and a hearing is to commence on September 16, 2015. *See* Declaration of Alexandra R. Clark, dated July 15, 2015 ("Clark Decl."), Ex. 1, at 2. Meanwhile, the AP, which we contend is in violation of the Appointments Clause, is in full bloom: The ALJ has heard and decided motions for partial summary disposition; the parties are engaged in a pretrial process in which they are required to file witness and exhibit lists on or before August 12, 2015; motions *in limine* and objections to witness and exhibit lists on or before August 19, 2015; prehearing briefs on or before September 2, 2015; and any stipulations on or before September 9, 2015. Accordingly, there is no question that the ongoing proceeding is imposing current, tangible burdens on Plaintiff. For this reason

[1] The SEC inaccurately claims that "[a]t a hearing on June 17, 2015, the Court denied Plaintiff's application for temporary restraining order and the request to file a second motion for a preliminary injunction." Defendants' Memorandum of Law in Support of Defendant's Motion to Dismiss ("Br.") at 6 (Dkt. No. 48). Rather, the Court declined to enter a TRO but directed the parties to consolidate briefing on Ms. Duka's (second) motion for preliminary injunction and the SEC's motion to dismiss the Amended Complaint. Transcript of June 17, 2015 Conference at 23 (Dkt. No. 45).

and those set forth more fully below, we respectfully submit that a ruling halting the AP is timely and fully warranted.[2]

In June 2015, just last month, in another administrative proceeding presided over by ALJ Cameron Elliot that is also subject to a lawsuit similar to the action Ms. Duka has filed here, the SEC Staff refused to respond directly to the SEC as to the precise manner in which ALJ Elliot was appointed. *See* Clark Decl., Ex. 2. ALJ Elliot, in response to the Staff's submission to the SEC, publicly corrected the Staff concerning the mistaken facts that it had seen fit to present:

> What I wanted to flag for the parties is that the Division's description [in *Timbervest*] of how I was hired is erroneous . . . .
>
> * * *
>
> So in my case, for example, I saw a posting on USA Jobs when I was at Social Security. I sent in my resume, I had an interview, I got an offer; it's as simple as that.
>
> * * *
>
> Oh, who did I interview with? I interviewed with Judge Murray, with Jayne Seidman, who at that time was – I think she was with human resources, and an attorney with the general counsel's office, whose name escapes me . . . . I was supposed to interview with the general counsel himself at the time, but he didn't bother to show up.
>
> * * *
>
> The bottom line, for purposes of Article II arguments, is that I was – I was not appointed by the Commission. The Commission, as far as I know, did not issue any sort of order appointing me as an ALJ.

See Clark Decl., Ex. 3, at 9, 19-21.

[2] The burdens imposed by these pre-hearing matters are substantial and include the attempted review of more than 800,000 documents received by the SEC during a two-year investigation, review of more than 65,000 emails and 15,000 related attachments of Ms. Duka alone, review of thirty-nine days of testimony; and other substantial pretrial preparation.

The apparent disarray at the SEC aside, the salient point is that our constitutional system requires that serious allegations such as those leveled here, involving core issues of the securities fraud law such as *scienter* and materiality, to the extent they are to be determined at all in an administrative setting, must at least be presided over by a tribunal that meets constitutional standards. As confirmed by the comments of ALJ Elliot, such a tribunal is absent here, and the Commission, for reasons that are nonpublic, has expressly refused to correct this constitutional infirmity. Accordingly, under the applicable preliminary injunction standards, the AP should be immediately enjoined in all respects.[3]

The SEC's motion to dismiss largely rests on a jurisdictional analysis that (a) this Court has already rejected; (b) would foreclose federal courts from acting even when presented with a constitutional violation that is wholly collateral to the substantive charges leveled in the administrative proceeding and outside the administrative agency's subject matter expertise; and (c) fails to deal with the jurisdictional necessity arising from the *de facto* officer doctrine, which requires that the Appointments Clause issue presented here be decided at this stage of this proceeding, not many years hence on appeal, when the SEC would undoubtedly invoke this doctrine to insulate an earlier flawed proceeding.

The SEC also continues to assert that the ALJ is not an "inferior officer," and therefore that the Appointments Clause has not been violated; and that the tenure protection enjoyed by SEC ALJs does not offend *Free Enterprise Fund v. Public Co. Accounting Oversight Board*, 561 U.S. 477 (2010) ("*Free Enterprise*"). It also argues that the SEC has not violated 15 U.S.C. § 78d-1(a) by failing to publish its determination to delegate to its employees its powers to appoint administrative law judges. As set forth below, these contentions all lack merit.

[3] That the proceeding also violates 15 U.S.C. § 78d-1(a), as alleged in Ms. Duka's claim under the Administrative Procedure Act ("APA"), only strengthens this conclusion.

STATEMENT OF THE CASE

At all times relevant to this action, Ms. Duka was employed by Standard & Poor's Rating Services ("S&P") in S&P's commercial mortgage backed securities ("CMBS") ratings function. *See* Amended Complaint ¶ 10 (Dkt. No. 38). On January 21, 2015, the SEC commenced the AP by issuing the Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP"). *See* Clark Decl., Ex. 4. On January 22, 2015, the SEC issued an Order Scheduling Hearing and Designating Presiding Judge, designating SEC ALJ Elliot to preside. *See* Clark Decl., Ex. 5. On March 4, 2015, SEC ALJ Elliot issued a Scheduling Order under which the hearing shall commence on September 16, 2015, and the parties shall submit witness lists, exhibit lists, and expert reports by August 12, 2015, prehearing briefs on or before September 2, 2015, and any stipulations on or before September 9, 2015. *See* Clark Decl., Ex. 6.

On January 16, 2015, the original complaint was filed, seeking a permanent injunction of the AP and a declaratory judgment "that the statutory and regulatory provisions providing for the position and tenure protections of SEC ALJs are unconstitutional" as a result of the Supreme Court's decision in *Free Enterprise*. *See* Complaint ¶¶ 2, 61-64 (Dkt. No. 1). On April 15, 2015, concerning Ms. Duka's motion for a temporary restraining order and preliminary injunction (Dkt. Nos. 9, 14), this Court ruled that it has subject matter jurisdiction over the claims in the Complaint. *See* April 15, 2015, Decision & Order (Dkt. No. 33) ("Op."). The Court declined to reach the question whether the SEC ALJ is an "inferior officer," but noted that "[t]he Supreme Court's decision in *Freytag v. Commissioner*, 501 U.S. 868 (1991) . . . would appear to support the conclusion that SEC ALJs are also inferior officers." Op. at 16. The Court nevertheless denied Ms. Duka's application for preliminary relief on the ground that she "ha[d] not demonstrated a likelihood of success on the merits" because "congressional restrictions upon

the President's ability to remove quasi judicial agency adjudicators are unlikely to interfere with the President's ability to perform his executive duties" and therefore "the statutory restrictions on ALJs' removal from office are both appropriate and constitutional." Op. at 15, 17, 19 (internal quotation marks omitted). The Court did not reach the questions "whether there would be irreparable harm absent injunctive relief, and whether the public interest weighs in favor of granting an injunction." Op. at 21.

Subsequently, in a letter to the Court, the SEC acknowledged that an SEC ALJ assigned to preside over an administrative proceeding subject to a collateral challenge similar to the challenge Ms. Duka raises here was not appointed by the SEC Commissioners. *See* May 28, 2015 Letter to the Court (Dkt. No. 35). Ms. Duka filed the Amended Complaint on June 10, 2015, adding causes of action for a permanent injunction of the AP and a declaratory judgment that (1) the AP was unconstitutional because the SEC ALJ was not appointed in accordance with the Appointments Clause of Article II of the Constitution, and (2) the AP contravened 15 U.S.C. § 78d-l(a) because the Commission delegated its authority to appoint SEC ALJs without evidencing such delegation "by published order or rule." *See* Amended Complaint (Dkt. No. 38). On June 17, 2015, the Court, in a hearing, inquired of counsel representing the SEC whether the SEC would be taking action to cure the absence of Commission appointment of ALJ Elliot; counsel replied that the SEC did not so intend. The Court then directed the parties to consolidate briefing on Ms. Duka's motion for preliminary injunction and the SEC's motion to dismiss the Amended Complaint and denied Ms. Duka's request for a temporary restraining order in the interim. *See* Transcript of June 17, 2015 Conference at 9-12, 23 (Dkt. No. 45).

ARGUMENT

POINT I

THIS COURT, AS IT HAS PREVIOUSLY RULED, HAS SUBJECT MATTER JURISDICTION OVER MS. DUKA'S CONSTITUTIONAL CLAIMS

Ms. Duka may raise her constitutional claims in this Court to the extent that (1) "a finding of preclusion could foreclose all meaningful judicial review" of her claims; (2) her claims are "wholly collateral" to the AP; and (3) her claims are "outside the [SEC's] expertise." *Free Enterprise*, 561 U.S. at 489 (citing *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212-13 (1994)); *see also Altman v. S.E.C.*, 768 F. Supp. 2d 554, 559 (S.D.N.Y. 2011), *aff'd*, 687 F.3d 44 (2d Cir. 2012) ("*Altman*"); *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 512 (S.D.N.Y. 2011); *Chau v. S.E.C.*, 14 Civ. 1903 (LAK), 2014 WL 6984236, at *3 (S.D.N.Y. Dec. 11, 2014). This Court has already concluded that "it has subject matter jurisdiction to evaluate [Ms. Duka's] application . . . for injunctive relief" because "all three of these criteria are met." Op. at 10, 15. Acknowledging that another court has similarly so held (*see Hill v. S.E.C.*, 15 Civ. 1801 (LMM), Dkt. No. 28, at 15 (N.D. Ga. June 8, 2015) ("*Hill*")), the SEC also points to rulings by two judges of this Court that reach a different conclusion. *See* Br. 7-8 & n.3. As set forth below, this Court's ruling was sound, especially in view of an issue that has not been raised before any of the previous courts addressing jurisdiction.

As an initial matter, independent of the three-factored analysis cited above, 28 U.S.C. § 1331 confers on federal district courts subject matter jurisdiction over "civil actions arising under the Constitution." "[I]t is established practice for [the Supreme] Court to sustain the jurisdiction of federal courts to issue injunctions to protect rights safeguarded by the Constitution," *Bell v. Hood*, 327 U.S. 678, 684 (1946); *Free Enterprise*, 561 U.S. at 491 n.2. The SEC argues that *Altman* holds otherwise, Br. 12, but the district court in *Altman* made a

point to distinguish the case before it, in which the plaintiff challenged the "extent of the SEC's ability to sanction attorneys under the SEC's own rules," from situations in which, as here, the "existence" of the AP proceeding itself is challenged. *Altman*, 768 F. Supp. 2d at 561. The SEC also points to various statutes regarding SEC cease and desist orders. *See* Br. 7. But those provisions relate to orders issued by the SEC "to enforce the provisions of the securities laws," S. Rep. No. 101-337 at 14 (1990); *see also* 15 U.S.C. § 77h-1(a). They have nothing to do with collateral challenges to the constitutionality of an SEC process.

A. Meaningful Judicial Review of Ms. Duka's Constitutional Claims Is Only Available in this Court

Here, the absence of subject matter jurisdiction "'could foreclose all meaningful judicial review'" of Ms. Duka's claim. Op. at 10 (quoting *Free Enterprise*, 561 U.S. at 489). Ms. Duka is not challenging the allegations leveled by the SEC in the AP, but instead seeking on constitutional grounds to prevent the AP from proceeding further. *Id.* at 11 (citing *Bond v. United States*, 131 S. Ct. 2355, 2365 (2011)). Thus, the denial of subject matter jurisdiction would effectively neuter judicial review. *See* Op. at 10 (citing *Free Enterprise*, 561 U.S. at 489; *Thunder Basin*, 510 U.S. at 212-13).[4]

The SEC again cites *Elgin v. Department of the Treasury*, 132 S. Ct. 2126 (2012), *see* Br. 7-10, but in *Elgin*, as this Court noted, Op. at 13-14, there was nothing collateral to the challenge

[4] As cited by this Court, for example, in *Ortiz v. Meissner*, 179 F.3d 718 (9th Cir. 1999), the district court exercised subject matter jurisdiction over a claim for injunctive relief against the U.S. Immigration and Naturalization Service ("INS") in which plaintiffs claimed they could not seek interim work authorization while awaiting review of their deportation proceedings, *see id.* at 722, because review of their claim would be moot after a final order of deportation was entered; *see also Fox v. Board of Trustees of State University of New York*, 42 F.3d 135, 140 (2d Cir. 1994) (constitutional claim by former university students moot because "after their graduation . . . it becomes impossible for the courts . . . to do anything to redress the injury.") (internal quotation marks omitted).

brought by petitioners in that case because they sought relief from terminations of employment that was routinely afforded by the civil service agency involved in that case.

This Court also noted that absent jurisdiction, Ms. Duka would have no avenue for effective relief from an unconstitutional proceeding should it terminate in her favor or settle. *See* Op. at 12 n.11. The SEC responds by citing *Federal Trade Commission v. Standard Oil Co. of California*, 449 U.S. 232 (1980), arguing that Ms. Duka must endure an unconstitutional AP and agency appeals process before bringing suit in an Article III forum. Br. 9. But *Standard Oil* did not involve a collateral challenge to the constitutionality of the administrative proceeding; rather, respondent there averred that the Federal Trade Commission ("FTC") did not have "reason to believe" the allegations contained in the FTC complaint, a challenge directed at the merits of the underlying FTC agency action. *See Standard Oil*, 449 U.S. at 234.

Contrary to the SEC's argument, Br. 8-9, *Free Enterprise* does not hold that subject matter jurisdiction in a district court only obtains when a respondent in an AP would otherwise be forced to violate an agency rule or order to obtain review of her claim within the agency process. Rather, as the Court noted in *Chau v. SEC*, 14 Civ. 1903 (LAK), 2014 WL 6984236 (S.D.N.Y. Dec. 11, 2014), *Free Enterprise* and *Thunder Basin* "teach that the question of whether a special statutory scheme provides for adequate review involves case-specific determinations." *Id.* at *5. That case-specific inquiry "depends in significant part on the nature of the constitutional claim at issue – whether it is 'wholly collateral to a statute's review provisions' – and on a party's ability to litigate that claim in an administrative proceeding and obtain adequate judicial review if it loses . . . ." *Id.* (quoting *Thunder Basin*, 510 U.S. at 212-13).

In addition to the reasons elucidated by this Court, another basis establishes this Court's jurisdiction so as to preserve meaningful judicial review: following an AP in which the

presiding ALJ was not appointed consistent with the Appointments Clause, the SEC, on respondent's appeal, would likely invoke the "*de facto* officer doctrine." At the request of the government, courts have employed this doctrine to uphold actions of officers whose appointments were defective because they violated the Appointments Clause. *See, e.g.*, *Office of Thrift Supervision v. Paul*, 985 F. Supp. 1465, 1475-76 (1997) (doctrine confers "validity upon acts performed by a person acting under color of official title even though it is later discovered that the legality of that person's appointment . . . is deficient") (citing *Ryder v. United States*, 515 U.S. 177, 179 (1995)). Because the doctrine applies only *after* an administrative decision is challenged, the SEC could raise this argument for the first time in the appellate court and possibly preclude review of Ms. Duka's Appointments Clause claim. *See Ryder*, 515 U.S. at 180-81. Meaningful judicial review of Ms. Duka's Appointments Clause claim without risk that such review will never occur is therefore only available if this Court assumes jurisdiction over this case.[5]

In sum, judicial review, to be meaningful, must take place now. An appellate ruling would not unscramble the eggs represented by the ongoing unconstitutional AP, and the potential sanctions and reputational injury that may result. *See* Op. at 11-12; *Hill* at 15 ("Plaintiff's claims would be moot and his remedies foreclosed because the Court of Appeals cannot enjoin a proceeding which has already occurred.").

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[5] *See Olympic Fed. Sav. & Loan Ass'n v. Dir. Office of Thrift Supervision*, 732 F. Supp. 1183, 1201 (D.D.C. 1990) ("If OTS and FDIC will not or can not waive the right to assert the *de facto* officer doctrine in a post-appointment proceeding, Olympic's injury would be compounded because it would permanently lose its right to challenge Mr. Martoche's authority to act as OTS' Director. If a receiver or conservator is appointed and that appointment is then validated under the *de facto* officer doctrine, Olympic's constitutional claim would be moot and Olympic would forever be barred from challenging the manner in which the government took away its business. This additional injury . . . renders FIRREA's judicial review provision inadequate." (internal citation omitted))

B. Ms. Duka's Constitutional Claims Are Wholly Collateral to the Review of Provisions of the Securities Laws

As the Court explained, (1) Ms. Duka attacks the constitutionality of the AP itself, and not any particular order that may result from such Proceeding; (2) "courts are more likely to sustain pre-enforcement jurisdiction over broad facial" challenges, such as Ms. Duka's; and (3) *Elgin* is distinguishable because it dealt not with collateral claims, but run-of-the-mill grievances routinely handled by the administrative agency in that case. Op. at 12-13; *see also Hill* at 19-21 (distinguishing *Elgin*). Accordingly, Ms. Duka's constitutional claims are wholly collateral to provisions of the securities laws.

Relying on *Tilton v. S.E.C.*, 15 Civ. 2472 (RA), Dkt. No. 24 (S.D.N.Y. June 30, 2015),[6] the SEC nevertheless argues that the instant constitutional claims are not wholly collateral because they could be raised as affirmative defenses in the AP. Br. 12-13. Whether a claim of constitutional violation can be pleaded as a defense in an administrative proceeding is not telling of the collateral nature of the claim. Indeed, followed to its logical conclusion, such a rule would preclude district courts from enjoining an administrative proceeding even where the claims brought by the SEC were not authorized by the securities laws or violated constitutional provisions such as the Equal Protection Clause. That does not make sense. *See Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 513 (S.D.N.Y. 2011).[7]

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[6] The SEC relies on a decision in *Tilton* that has been appealed to the Second Circuit, *see* Form C, Case No. 15-2103, Doc. 12 (2d Cir. July 8, 2015), where it is proceeding on an expedited schedule, *see* Order, Case No. 15-2103, Doc. 22 (2d Cir. July 9, 2015).

[7] At oral argument in *Jarkesy v. S.E.C.*, No. 14-5196 (D.C. Cir. Apr. 13, 2015), SEC counsel was asked, in connection with the meaningful review prong of *Free Enterprise*, if a district court could enjoin an enforcement proceeding the SEC had instituted on the basis of an EPA violation. Counsel conceded that such a case "probably would not be something that can achieve meaningful review through our process." *See* Clark Decl., Ex. 7, at 35. Later, counsel stated that the hypothetical was "a little far afield" and that it indeed is the SEC's position that

C. Ms. Duka's Constitutional and Statutory Claims are Outside the SEC's Expertise

The issues presented by Ms. Duka's constitutional and statutory claims are outside the SEC's expertise. *Compare, e.g., Whitney Nat. Bank in Jefferson Parish v. Bank of New Orleans & Trust Co.*, 379 U.S. 411, 420 (1965) (administrative review is "designed to permit agency expertise to be brought to bear on particular problems"), *with Adkins v. Rumsfeld*, 389 F. Supp. 2d 579, 588 (D. Del. 2005) (constitutional questions "are particularly suited to the expertise of the judiciary"). Indeed, none of the courts that has recently addressed challenges to SEC administrative proceedings have ruled otherwise. *See, e.g.*, Op. at 14-15 ("the constitutional claim passed in this injunctive/declaratory judgment case is outside the SEC's expertise"); *Hill* at 8 ("[t]he court finds that Plaintiff's . . . Article II claims are outside the agency's expertise"); *Tilton*, 15 Civ. 2472 (RA), Dkt. No. 24, at 21 (S.D.N.Y. June 30, 2015) ("the Court recognizes that the particular constitutional questions here may not be within the SEC's expertise"). The SEC's response (Br. 14) is to assert that it is expert at interpreting its own Rules of Practice and authority under the securities law. But those areas of specialty, if assumed here for purposes of argument, do not bear on expertise to adjudicate Constitutional standards or claims brought under the APA.

POINT II

THE MOTION TO DISMISS THE AMENDED COMPLAINT SHOULD BE DENIED AND A PRELIMINARY INJUNCTION ENTERED IN FAVOR OF MS. DUKA

Under Rule 12(b)(6), "[t]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S.

"you could have judicial review at the end of the day . . . ." *Id.* at 37. Here, in the context of the "wholly collateral" question, the SEC takes effectively the same breathtakingly broad position.

544, 570 (2007)). "The purpose of Rule 12(b)(6) is to test, in a streamlined fashion, the formal sufficiency of the plaintiff's statement of a claim for relief without resolving a contest regarding its substantive merits. The Rule thus assesses the legal feasibility of the complaint, but does not weigh the evidence that might be offered to support it." *Global Network Commc'ns, Inc. v. City of New York*, 458 F.3d 150, 155 (2d Cir. 2006).

To obtain a preliminary injunction against government action "pursuant to a statutory scheme, a moving party must demonstrate that (1) [she] is likely to succeed on the merits of the underlying claim, (2) [she] will suffer irreparable harm absent injunctive relief, and (3) the public interest weighs in favor of granting the injunction." *Pope v. Cnty. of Albany*, 687 F.3d 565, 570 (2d Cir. 2012). "The Supreme Court also require[s] the plaintiff to show a fourth factor, that the balance of equities tips in [her] favor." *Id.* at 570 n.3 (citing *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 20 (2008)). As set forth below, Ms. Duka has amply satisfied this standard.

The Amended Complaint pleads causes of action for declaratory relief and an injunction, asserting two constitutional claims under Article II of the Constitution, to wit, (1) that the ALJ's designation to preside over the AP violates the Appointments Clause because the ALJ, an "inferior officer" under Article II, may only so preside on due and proper appointment by a constitutional Officer, here, the Commission, and (2) that the ALJ, as an inferior officer, may not preside over the AP under *Free Enterprise* because he enjoys two levels of tenure protection, insulating him unconstitutionally from the President's power to appoint and remove executive branch officers. Each of these claims is more than adequately pleaded and, indeed, should serve in the present circumstances as grounds for a preliminary injunction.

A. SEC ALJs Are "Inferior Officers" of the United States

The SEC disputes that SEC ALJ's are inferior officers.[8] Following briefing and argument, this Court observed without deciding that "[t]he Supreme Court's decision in *Freytag v. Commissioner*, 501 U.S. 868 (1991), which held that a Special Trial Judge of the Tax Court was an 'inferior officer' under Article II, would appear to support the conclusion that the SEC ALJs are also inferior officers." Op. at 16 (quoting *Freytag*, 501 U.S at 881-82). For the reasons previously articulated by Ms. Duka and as further set forth below, SEC ALJs are indeed inferior officers, given their "significant authority," and the SEC's arguments to the contrary lack merit.

1. The Broad and Substantial Powers of SEC ALJs

Under the SEC Rules of Practice ("Rules" or in the singular "Rule") and other SEC regulations, an SEC ALJ is empowered to perform numerous discretionary functions, among others: (a) to regulate "the course of a proceeding and the conduct of the parties and their counsel" (Rule 111(d)); (b) to "examine witnesses" (17 C.F.R. § 200.14(a)(4)); (c) to issue orders (Rule 141(b)); (d) to rule on requests and motions, including pre-trial motions for summary disposition (*see, e.g.*, Rule 250); (e) to impose sanctions on parties for contemptuous conduct (Rule 180(a)); and (f) to enter orders of default, and rule on motions to set aside defaults (Rule 155). At the close of an administrative proceeding, the SEC ALJ issues a decision, referred to in the Rules as the "initial decision." Rule 360(a)(1). *See* Mem. in Support of T.R.O. ("T.R.O. Mem."), Jan. 26, 2015, at 8-9 (Dkt. No. 14).

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[8] Article II divides "officers" into two categories: principal officers and inferior officers. *Com. of Pa., Dep't of Pub. Welfare v. U.S. Dep't of Health & Human Servs.*, 80 F.3d 796, 801 (3d Cir. 1996). The Supreme Court has explained that "any appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States,' and must, therefore, be appointed in the manner prescribed by § 2, cl. 2, of [Article II]." *Buckley v. Valeo*, 424 U.S. 1, 126, (1976).

2. The "Significant Authority" Exercised by SEC ALJs Renders Them Inferior Officers

SEC ALJs exercise "significant authority pursuant to the laws of the United States," and are thus "inferior Officers" under Article II. In *Freytag*, the Supreme Court determined that special trial judges ("STJs") appointed by the Tax Court were Officers because "the office . . . is established by Law . . . the duties, salary, and means of appointment for that office are specified by statute . . . [and] special trial judges perform more than ministerial tasks." *Freytag*, 501 U.S. at 881-82 (internal quotation marks omitted). The same reasoning applies to SEC ALJs.

SEC ALJs are "established by Law." Under 5 U.S.C. § 3105, "[e]ach agency shall appoint as many administrative law judges as are necessary for proceedings required to be conducted in accordance with sections 556 and 557 of this title." Regulation establishes the "Office of Administrative Law Judges" at the SEC and describes their authority. *See, e.g.*, 17 C.F.R. § 200.14; 17 C.F.R. § 200.30-9; 17 C.F.R. § 201.111.[9] The APA, 5 U.S.C. § 500 *et seq*., establishes the powers of the ALJ with respect to adjudication, 5 U.S.C. §§ 556, 557, and the securities laws empower the SEC to delegate certain functions to SEC ALJs, including those listed above. *See* 15 U.S.C. § 78d-l. The salaries of SEC ALJs are specified by 5 U.S.C. § 5372. And, as in *Freytag*, the manner of appointment of SEC ALJs is specified by statute and regulation. By regulation, SEC ALJs may be appointed from a list of eligible candidates provided by the Office of Personnel Management ("OPM") or with prior approval of OPM. 5 C.F.R. § 930.204. Further, like STJs, SEC ALJs "perform more than ministerial tasks." *Freytag*, 501 U.S. at 881. As in the case of the STJs reviewed in *Freytag*, SEC ALJs, among other discretionary functions, "take testimony, conduct trials, rule on the admissibility of

[9] The regulations confer on the hearing officer authority over adjudications as broad as permitted under the APA. *See* 17 C.F.R. § 201.111.

evidence, and have the power to enforce compliance with discovery orders." *Id.*; *see* 17 C.F.R. § 200.14(a).

Indeed, SEC ALJs are not distinguishable in any meaningful way from the STJs deemed officers in *Freytag*. *Freytag*, 501 U.S. at 910 (Scalia, J., concurring in part and concurring in judgment) (ALJs "are all *executive* officers.") (emphasis in original, internal citation omitted). The court in *Hill*, citing the many important functions carried out by SEC ALJs, agreed. *See Hill* at 36-37 ("based upon the Supreme Court's holding in *Freytag*, SEC ALJs are inferior officers") (citing *Duka v. S.E.C.*, 15 Civ. 357 (RMB), Dkt. No. 33, 2015 WL 1943245, at *8 (S.D.N.Y. Apr. 15, 2015));[10] *see also Landry v. FDIC*, 204 F.3d 1125, 1143 (D.C. Cir. 2000) (Randolph, J. concurring in part and concurring in judgment) (citations and quotation marks omitted) ("[t]he [FDIC] ALJ in this case is an inferior officer . . . . He may issue subpoenas, rule on proffers of evidence, regulate the course of the hearing, and make or recommend decisions . . . . [I]t has long been settled that federal magistrates are inferior Officers under Article II.").

Re-offering its previous arguments to this Court, all of which were considered and rejected by the *Hill* court, *Hill* at 36, the SEC argues that SEC ALJs do not have "significant authority" because they do not issue "final" decisions. But *Freytag* expressly rejected this argument: "*Commissioner reasons that special trial judges may be deemed employees . . . because they lack authority to enter a final decision. But this argument ignores the significance of the duties and discretion that special trial judges possess*." 501 U.S. at 881 (italics added).

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[10] The Supreme Court has repeatedly treated military tribunal hearing officers as "Officers" for purposes of Article II. *See, e.g.*, *Weiss v. United States*, 510 U.S. 163, 169 (1994) ("military judges, because of the authority and responsibilities they possess, act as 'Officers' of the United States"); *Edmond v. United States*, 520 U.S. 651, 661-63 (1997) (evaluating whether military judges are principal or inferior Officers for purposes of Article II); *Ryder v. United States*, 515 U.S. 177, 180 (1995) (acknowledging lower court's determination that "appellate military judges are inferior officers").

Freytag also cited favorably to a Second Circuit decision in which the Circuit recognized that the authority to issue final decisions is not determinative of whether an official is an Officer. *See id.* (citing *Samuels, Kramer & Co. v. Comm'r*, 930 F.2d 975, 985-86 (2d Cir. 1991) (holding that STJs are Officers without any reference to their power to make final decisions)). In any event, SEC ALJ decisions can become final without further Commission review. *See* 17 C.F.R. § 201.411(b).

The SEC points to language in *Landry* to argue that under *Freytag*, SEC ALJs are not Officers because they do not issue "final decisions." Br. 17-18 (citing *Landry*, 204 F.3d at 1133-34). As explained in Judge Randolph's concurrence in *Landry*, and elucidated by Judge May in *Hill*, the holding in *Freytag* was based on the significant powers of the STJ, not whether the STJs issue "final" decisions. *Landry*, 204 F.3d at 1142 (Randolph, J., concurring in part and in judgment) ("[T]he majority neglects to mention . . . that the Court [in *Freytag*] clearly designated [the ability to render final decisions] as an alternative holding . . . . *Freytag* concluded that "although special trial judges may not render final decisions, they are nevertheless inferior officers of the United States."); *Hill* at 38-40 (*Freytag* made clear its holding would have been the same even if the STJ's opinion, in all cases, could only become final after Tax Court review).[11] The SEC's interpretation of *Landry* is also inconsistent (1) with *Samuels, Kramer & Co.*, which was cited with approval in *Freytag*; and (2) an opinion by the Office of Legal Counsel stating that Department of Education ALJs are inferior officers, *see Sec. of Ed. Review of Admin. Law Judge Decisions*, 15 Op. O.L.C. 8, 14 (1991) (noting that ALJs are appointed in

[11] In holding that FDIC ALJs are not Officers, *Landry* pointed to a *de novo* standard of review by the FDIC of its ALJ's factual decisions, 204 F.3d at 1133; here, review by the Commission, when it occurs, of an SEC ALJ's factual and credibility findings, is performed under a "clearly erroneous" standard, 17 CFR § 201.411(a)(2)(ii)(A), as was the case in *Freytag* (in respect of the Tax Court's review of its STJs' findings).

the manner of inferior officers although their decisions are reviewed by the Secretary and the Department of Education).

Moreover, that the *Landry* majority wrongly interpreted *Freytag* is evident from the fact that whether officers have the authority to render final decisions is what distinguishes principal officers from inferior officers; the same distinction does not also distinguish inferior officers from employees. *See Edmond*, 520 U.S. at 665; Brief for the United States, *Free Enterprise*, No. 08-861, 2009 WL 3290435, at *32 n.10 (Oct. 13, 2009) ("In any event, as *Edmond* makes clear, the Board's inability to render a final decision on behalf of the Executive Branch unless 'permitted to do so by other Executive Officers' is itself indicative of inferior, not principal, officer status."); *Dep't of Trans. v. Assoc. of Am. RR* ("*Amtrak*"), 135 S. Ct. 1225, 1238 (2015) (Alito, J., Concurring) ("Inferior 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.").

The SEC further contends that it is relevant that SEC ALJs lack the power "to punish contempt by fines or imprisonments" and that, in cases of noncompliance with a subpoena issued by an SEC ALJ, the SEC would need to move to compel compliance in a federal court. Br. 19-20. This point was not deemed significant in *Freytag*; indeed, the portion of *Freytag* cited in this regard by the SEC does not even relate to the Court's ruling that STJs are inferior officers. Rather, it concerns the Supreme Court's holding that the Tax Court is an Article I "Cour[t] of law." *Freytag*, 501 U.S. at 891.

The SEC also argues that SEC ALJs are not Officers because the SEC has discretion in "whether and how to use ALJs," Br. 15, and because Congress "did not impose ALJs on the Executive Branch." Br. 16. These observations do nothing to distinguish SEC ALJs from the STJs in *Freytag*: Congress did not require the Chief Judge of the Tax Court to use STJs either.

See Freytag, 501 U.S. at 807; 26 U.S.C. § 7443A(a) ("The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.").

The SEC also urges this Court to "defer to Congress's long-standing judgment that ALJs are employees." Br. 20. As an initial matter, the SEC's position is based on the flawed premise that Congress uniformly treats ALJs as employees. That is untrue. *See* 5 U.S.C. § 4301(2)(D) (exempting ALJs from the definition of the term "employee"); 15 U.S.C. § 78d-1(a) (permitting the SEC to assign administrative cases to be heard before "a division of the Commission, an individual Commissioner, an [ALJ], or an employee or employee board"). Moreover, the SEC directs this Court to no case in which a court considered this factor in determining whether a government official is an Officer; nor would such a factor make any sense in an Appointments Clause challenge. Thus, when faced with the same argument, the Court in *Hill* found that Congress "may not 'decide' that an ALJ is an employee, but then give him the powers of an inferior officer; that would defeat the separation-of-powers protections the [Appointments] Clause was enacted to protect." *Hill* at 41. In analogous circumstances, the Supreme Court also recently considered and rejected an argument that it should defer to the judgment of Congress, and held that "Congressional pronouncements . . . are not dispositive." *Amtrak*, 135 S. Ct. at 1238 (in holding that Amtrak is a government entity, Supreme Court explicitly rejected argument that it should defer to the judgment of Congress that Amtrak was a "for profit corporation" and "not a department, agency, or instrumentality of the United States Government").[12]

[12] The SEC's argument that *Hill* was wrongly decided because it is contrary to Congressional intent fails for this same reason. *See Amtrak*, 135 S. Ct. at 1238.

3. The Effective Finality of Decisions Issued by SEC ALJs Is a Component of Their "Significant Authority"

With certain narrow exceptions that do not apply to this matter,[13] the Commission is *not* required to review an SEC ALJ's "initial decision." SEC ALJs frequently render decisions that by "rubber stamp" order become final decisions of the SEC without review[14]: "*When the presiding employee makes an initial decision, that decision then becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule*." 5 U.S.C. § 557(b) (italics added); *see also* Rule 411(b)(2) ("The Commission may decline to review any other decision" aside from those listed in Rule 411(b)(1)).

"In determining whether to grant [discretionary] review," the Commission considers "whether the petition for review makes a reasonable showing that: (i) a prejudicial error was committed in the conduct of the proceeding; or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; or (B) a conclusion of law that is erroneous; or (C) an exercise of discretion or decision of law or policy that is important and that the Commission should review." Rule 411(b)(2). If a respondent does not file a petition for review, "and if the Commission does not order review of a decision on its own initiative, the Commission will issue an order that the [initial] decision [of the SEC ALJ] has become final."

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[13] *See* T.R.O. Mem. at 10 n.5.

[14] Although the SEC attempts to erect a straw man, by arguing that Ms. Duka claims that SEC ALJs have final decision-making authority, *see* Br. 17 n.9, that has never been Plaintiff's position. Rather, we have argued that SEC ALJs exercise "significant authority," including to issue hearing determinations that the SEC regularly rubber stamps as final orders without Commission review. In any event, as explained in *Freytag*, whether a hearing officer's decision is a "final" decision under an agency rule of procedure is not determinative as to whether the hearing officer exercises "significant authority" under the laws of the United States and is thus an inferior officer. *Freytag*, 501 U.S. at 881.

Rule 360(d)(2). Upon issuance of the order that the SEC ALJ's initial decision has become final, referred to as an "order of finality," *see* Rule 360(d)(2), "the action of [the] administrative law judge ... shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 15 U.S.C. § 78d-1(c).

In practice, the SEC ALJ's initial decision is often the final word, another indicium of "significant authority." For example, in 2014, 167 cases available on Westlaw were SEC ALJ's decisions that were not reviewed by the Commission but simply endorsed as final. *See* Declaration of Daniel Goldman, dated Jan. 26, 2015 (Dkt. No. 15), Ex. 5.

B. The AP Violates the Appointments Clause Because the ALJ Was Not Appointed by the Commission

The SEC concedes that Congress established "a method for appointing [ALJs] that does not track the requirements for appointing constitutional officers," Br. at 2; *see also Hill* at 7, 41 (noting SEC's concession that ALJ "was not appointed by an SEC Commissioner" and that, generally, "SEC ALJs are not appointed by the President, the Courts, or the [SEC] Commissioners"). Rather, SEC ALJs "are hired by the SEC's Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resource functions, and the Office of Personnel Management." *Hill* at 7.

In this case, ALJ Elliot, the ALJ assigned to this AP, "was not hired through a process involving the approval of the individual members of the Commission." Clark Decl., Ex. 2, at 6. Rather, according to ALJ Elliot himself, "[t]he bottom line, for purposes of Article II arguments, is that I was – I was not appointed by the Commission. The Commission, as far as I know, did not issue any sort of order appointing me as an ALJ." *See* Clark Decl., Ex. 3, at 21. As a result, ALJ Elliot was not appointed by the "Head[] of [a] Department[ ]," *see* U.S. Const. art. II, §2, cl. 2, and his assignment is contrary to Article II.

The problem, moreover, is not one that will be cured by SEC action. The government has already made clear to the Court that the SEC has no intention of appointing ALJ Elliot. Notably, it takes this position despite the fact that other agencies of the federal government have recognized that ALJs need to be appointed by the "Head[] of [a] Department[]" in order to comply with the Appointments Clause. *See, e.g.*, 8 C.F.R. § 1003 .10 ("immigration judges are attorneys whom the Attorney General appoints as administrative judges"); 20 U.S.C. § 1234(b) ("The administrative law judges [for the Department of Education] . . . shall be appointed by the Secretary in accordance with section 3105 of Title 5.").

C. The AP Is Unconstitutional Because the ALJ Enjoys at Least Two Levels of Tenure Protection

In denying Ms. Duka's first application for a preliminary injunction, this Court rejected the proposition that the statutory restrictions on the removal of SEC ALJs are "so structured as to infringe the President's constitutional authority." Op. at 20. The Court cited to the ALJs' adjudicatory functions, and distinguished these functions from the rulemaking or enforcement actions of executive branch employees, concluding that "[the challenged (good cause) limitations upon the removal of an SEC ALJ will in no way impede the President's ability to perform his constitutional duty." Op. at 20. The Court also cited the ostensible benefits of the "good cause" standard in protecting the independence of the hearing examiner. Op. at 20 (citing *Butz v. Economou*, 438 U.S. 478, 513-14 (1978)).

We respectfully preserve our previous argument for appeal, solely further citing Justice Scalia's observation in his opinion in *Freytag*, concurring in part and dissenting in part, that, "given the performance of adjudicatory functions by a federal officer, it is the *identity* of the officer—not something intrinsic about the mode of decisionmaking or type of decision" that makes her an inferior officer for Article II purposes." *Freytag*, 501 U.S. at 911 (Scalia, J.,

concurring in part and dissenting in part) (italics added). Accordingly, the AP should be enjoined as a violation of the separation of powers mandate of Article II.

POINT III

MS. DUKA'S CLAIM UNDER THE APA IS SUFFICIENTLY PLEADED AND LIKELY TO SUCCEED ON THE MERITS

An injunction should also immediately be entered, and the SEC's motion denied, because Ms. Duka's well-pleaded claim under the APA is likely to prevail.[15] Pursuant to 5. U.S.C. § 706, this Court may hold unlawful and set aside agency actions not in accordance with the law, or in excess of statutory authority. Under the 15 U.S.C. § 78d-1(a), delegations of functions by the SEC require disclosure to the public by published order or rule. As confirmed by the SEC's brief, the SEC has never complied with this statutory mandate.

Title 15 U.S.C. § 78d-1(a) vests the SEC with authority to "delegate . . . any of its functions," but requires public notice of such delegation by "published order or rule." As the SEC concedes, "the SEC hired its ALJs without the direct involvement of the Commission or a published delegation of the authority specifically to hire ALJs." Br. 25. The SEC's failure to publish to the public its delegation of authority to appoint SEC ALJs violates § 78d-1(a).

The SEC provides no support for its blanket assertion that § 78d-1(a) "is not pertinent to the SEC's hiring of ALJs." Br. 25. The provision, on its face, applies to all SEC functions. And, the other provisions to which the SEC cites are irrelevant: the reorganization plan (Br. 25) is not a published order of the SEC, as required under section 78d-1(a); and even if the Commission Chairman has authority under that plan to delegate SEC ALJ appointments (Br. 25),

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[15] Under the APA, a "person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action . . . is entitled to judicial relief thereof." *Darby v. Cisneros*, 509 U.S. 137, 146 (1993) (quoting 5 U.S.C. § 702); *Sharkey v. Quarantillo*, 541 F.3d 75 (2d Cir. 2008). District courts, under 28 U.S.C. § 1331, have jurisdiction over suits arising under the APA. *Bowen v. Massachusetts*, 487 U.S. 879, 891 n.16 (1988).

the SEC does not claim that the Chairman has exercised such authority. The SEC also cites 5 U.S.C. § 3105, but that section provides that "[e]ach agency shall appoint as many administrative law judges as are necessary," and is of no relevance to 15 U.S.C. § 78d-1(a)'s requirement that delegations of authority be on notice to the public.

In violating Section 78d-1(a), the SEC hid from public view its murky practices in contravention of the Appointments Clause. Such conduct provides yet another reason for this Court to issue the requested injunction. Bureaucratic secrecy in violation of law should not be rewarded.

POINT IV

MS. DUKA WILL SUFFER IRREPARABLE HARM IF AN INJUNCTION IS NOT ORDERED

We have previously set forth the irreparable harm that Ms. Duka is suffering and will suffer from continuation of the AP. *See* T.R.O. Mem. at 17-18; T.R.O. Reply at 2-3. Although the Court did not address irreparable harm in its April 15 Opinion, we respectfully submit that it is appropriate to do so now given the merits of Ms. Duka's Appointments Clause claim.

As an initial matter, "[w]here there is a 'deprivation of a constitutional right, no separate showing of irreparable harm is necessary.'" *Alexandre v. New York City Taxi & Limousine Comm'n*, 07 Civ. 8175 (RMB), 2007 WL 2826952, at *5 (S.D.N.Y. Sept. 28, 2007) (*citing Statharos v. New York City Taxi & Limousine Comm'n*, 198 F.3d 317, 322 (2d Cir. 1999)); *see also Jolly v. Coughlin*, 76 F.3d 468, 482 (2d Cir. 1996) (a "presumption of irreparable injury . . . flows from a violation of constitutional rights"); *Hill* at 42.

Moreover, irreparable harm is otherwise clear and palpable. First, in the absence of relief, an administratively imposed sanction may take effect prior to Ms. Duka receiving any judicial review of her constitutional and statutory claims. *See* Rule of Practice 360(d)(2); 15

U.S.C. § 77i(a). Second, even if she prevails on her claim later, after the AP, Ms. Duka will have achieved a hollow victory, moot on appeal, *see* Op. at 12; *Hill* at 42-43, because she would have already incurred the cost, time, reputational injury, and other damages associated with the AP. Third, following reversal, the SEC likely could bring a new case in federal court. And, even if it could be monetized, [16] none of this harm would be compensable by money damages because of the sovereign immunity doctrine.[17]

Finally, *this Court* is the only forum in which Ms. Duka can obtain a ruling on her Appointments Clause challenge uncoupled from the risk of future invocation by the SEC of the "*de facto* officer" doctrine. *See supra* at Point I.

POINT V

THE BALANCE OF EQUITIES AND THE PUBLIC INTEREST STRONGLY FAVOR ISSUANCE OF AN INJUNCTION

The "balance of equities" and "public interest" factors of the preliminary injunction standard strongly counsel in favor of Ms. Duka's motion.

Ms. Duka, if the injunction is not ordered, will be required to continue to participate in a constitutionally infirm proceeding, will potentially incur sanctions, risk loss of a full opportunity to have her constitutional claim decided, and will face a possible second trial following appeal and reversal on one or both of her constitutional claims. The SEC, on the other hand, will incur no harm from the injunction. It can readily address at least one of the constitutional issues here by appointing the ALJ as an officer; it can also preside over the hearing itself or file the case in

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[16] *Rolex Watch U.S.A., Inc. v. City Styles 313, LLC*, No. 12 Civ. 4754 (AJN), 2012 WL 5992102, at *5 (S.D.N.Y. Nov. 29, 2012) ("[T]here are no adequate remedies at law because the permanent harm to Plaintiff's reputation cannot be adequately monetized.").

[17] *See Lipkin v. U.S. S.E.C.*, 468 F. Supp. 2d 614, 625 (S.D.N.Y. 2006); *Le v. S.E.C.*, 542 F. Supp. 2d 1318, 1324 (N.D. Ga. 2008) ("A plaintiff cannot bring a *Bivens* action against the federal agency that employs the agent.").

federal court. And, in all respects, it can appeal an adverse ruling and negate the risk of two trials. *See Hill* at 43.

The public interest would also be served by the issuance of an injunction that ensures government conduct in compliance with the Constitution. *Nat'l Treasury Emps. Union v. U.S. Dep't of Treasury*, 838 F. Supp. 631, 640 (D.D.C. 1993) ("the public may be deemed to have an overriding interest in assuring that the government remains within the limit of its constitutional authority"). Indeed, "it is [n]ever in the public interest for the Constitution to be violated." *Hill* at 43. The constitutional protections at the heart of the Amended Complaint safeguard the separation of powers and preserve the structural integrity of the Constitution. *See id.* The Court referred in its April 15 Opinion to the regulator's mission, *see* Op. at 15 n.13, but we do not understand the Court to have expressed the view that the Constitution can ever take a back seat to a general incantation by an enforcement bureaucracy that it is acting in the "public interest" or pursuant to its "mission." The public interest, respectfully, is served by holding the government to the requirements of the Constitution.

CONCLUSION

For all of the reasons set forth above, Ms. Duka respectfully requests that this Court grant an Order enjoining the SEC from continuing the AP and denying in its entirety the SEC's motion to dismiss the Amended Complaint.

Dated: July 15, 2015
New York, New York

Respectfully submitted,

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