ORAL ARGUMENT NOT YET SCHEDULED
Case No. 15-1416

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

TIMBERVEST LLC, *et al.*,
Petitioners,
v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petition for Review of a Decision and Order
of the Securities and Exchange Commission

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS, URGING REVERSAL

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CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

Parties and *Amici.* All parties, intervenors, and *amici* appearing before the Securities and Exchange Commission and this Court are listed in the Certificates as to Parties, Rulings, and Related Cases filed by Petitioners, except for Washington Legal Foundation (WLF), which intends to file an *amicus curiae* brief in support of Petitioners. WLF understands that two other organizations not listed by Petitioners—Ironridge Global IV, Ltd. and Ironridge Global Partners, LLC—may also be planning to file an *amicus brief* in support of Petitioners.

Rulings Under Review. The ruling under review in this case is the final decision of the Securities and Exchange Commission captioned *In the Matter of Timbervest, LLC, et al.*, Opinion of the Commission, Investment Advisors Act Release No 4197, Admin Proc. File No. 3-15519, 2015 WL 5472520 (Sept. 17, 2015); *In the Matter of Timbervest LLC, et al.*, Order Imposing Remedial Sanctions, Investment Advisors Act Release No. 4197, Admin. Proc. File No. 3-15519 (Sept. 17, 2015).

Related Cases. Counsel for WLF is unaware of any related cases before this Court or any other court, other than those cited by Petitioners.

/s/ Richard A. Samp
Richard A. Samp

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Pursuant to Circuit Rule 29(b), Fed.R.App.P. 26.1, and Circuit Rule 26.1, the undersigned counsel states that proposed *amicus curiae* Washington Legal Foundation (WLF) is a non-profit corporation; it has no parent corporations, and no publicly-held company has a 10% or greater ownership interest.

Pursuant to Circuit Rule 26.1(b), WLF describes its general nature and purpose as follows. WLF is a public-interest law and policy center that regularly appears in this Court in cases raising public policy issues. WLF has no financial ties with any party to this appeal.

/s/ Richard A. Samp
Richard A. Samp

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GLOSSARY

Advisors Act	Investment Advisors Act of 1940
ALJ	Administrative Law Judge
SEC	Securities and Exchange Commission
STJ	Special Trial Judge
WLF	Washington Legal Foundation

INTERESTS OF *AMICUS CURIAE*

Washington Legal Foundation is a public-interest law firm and policy center with supporters in all 50 States.[1] It devotes a substantial portion of its resources to defending and promoting free enterprise, individual rights, a limited and accountable government, and the rule of law.

To that end, WLF has appeared before this and other federal courts in numerous cases related to the proper scope of the federal securities laws. *See, e.g., Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015); *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014). WLF also frequently participates in cases raising separation-of-powers concerns under the Constitution. *See, e.g., Spokeo, Inc. v. Robins*, No. 13-1339 (U.S., argued Nov. 2, 2015); *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010).

WLF is concerned by the SEC's growing tendency to opt for enforcement of federal securities laws before its own administrative law judges rather than Article III judges. Recent experience demonstrates that the SEC nearly always prevails in its own in-house proceedings, but is far less successful when it litigates in federal court. WLF fears that if the SEC is able to influence the outcome of complex and novel

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[1] Pursuant to Fed.R.App.P. 29(c)(5), WLF states that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than WLF and its counsel, contributed monetarily to the preparation and submission of this brief. All parties have consented to the filing of this brief.

securities cases by merely pursuing them in an administrative proceeding rather than federal court, then investors' ability to predict the types of conduct that will result in sanction will be greatly diminished.

WLF is also concerned by the SEC's willingness to pursue enforcement actions many years after the events giving rise to those actions occurred. Congress has established a five-year limitations period for the enforcement of any civil fine, penalty, or forfeiture. The SEC has, nonetheless, over the past several decades raised a series of arguments regarding why that statute of limitations imposes virtually no constraints on its enforcement authority. WLF fears that if the Court accepts the SEC's arguments in this case, the five-year statute of limitations will be rendered a nullity.

WLF has not studied the administrative record in detail and takes no position on whether Petitioners' conduct violated federal securities laws. It is filing this brief for the sole purpose of addressing two issues raised by the petition for review: (1) whether the SEC's enforcement action is time-barred by 28 U.S.C. § 2462; and (2) whether the SEC's enforcement action violates separation-of-powers principles of the U.S. Constitution by placing enforcement authority in the hands of an administrative law judge who is doubly insulated from removal by the President.

STATEMENT OF THE CASE

The facts of this case are set out in detail in Petitioners' brief. WLF wishes to highlight several facts of particular relevance to the issues on which this brief focuses.

The Administrative Procedure Act (APA) authorizes executive agencies such as the SEC to conduct administrative proceedings before an Administrative Law Judge (ALJ). The SEC's Rules of Practice, 17 C.F.R. § 201.100, *et seq.*, provide that the SEC "shall" preside over all administrative proceedings either by the Commissioners handling the matter themselves or delegating the case to an ALJ. 17 C.F.R. § 201.110. When an ALJ is selected by the SEC to preside—as was done by the SEC in this case—the ALJ is selected by the Chief Administrative Law Judge. *Ibid.* The ALJ then presides over the matter, including an evidentiary hearing, and issues a decision. 17 C.F.R. § 201.360(a)(1). If there is no appeal and the SEC declines to review an ALJ's decision, that decision is "deemed the action of the Commission," 15 U.S.C. § 78d-1(c), and the SEC issues an order making the ALJ's decision final. 17 C.F.R. § 201.360(d)(2).

Appointed for life, the SEC's ALJs are removable "only for good cause established and determined by the Merit System Protection Board." 5 U.S.C. §§ 7521(a)-(b). Members of the Merit Systems Protection Board, who determine whether sufficient "good cause" exists to remove an ALJ, are themselves protected from removal absent "inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d).

The SEC's September 2015 Opinion determined that Petitioners violated Sections 206(1) and 206(2) of the Investment Advisors Act of 1940 (the "Advisors Act"), 15 U.S.C. § 80b-6(1), 6(2). *See* Opinion of the Commission, *In the Matter of Timbervest, LLC* , Sept. 17, 2015 ("Opinion"). It found that Petitioner Timbervest, LLC: (1) failed to disclose a conflict of interest in connection with the sale of timber property; and (2) caused its client to pay brokerage commissions that Timbervest did not earn. Opinion at 2. It further found that the four individual Petitioners "aided, abetted, and caused" Timbervest's misconduct. *Ibid*.

The events giving rise to the SEC's determination occurred in 2006 and 2007. Although the SEC began investigating the events in 2010, it did not initiate its administrative proceeding until 2013, more than five years after the relevant events occurred.

The ALJ conducted an administrative hearing in early 2014. His August 2014 Initial Decision concluded that Petitioners had violated the Advisors Act. It ordered Petitioners to cease and desist from further violations and to disgorge $1.9 million in funds allegedly generated by the violations. He declined to issue an order barring the individual Petitioners from associating with any investment advisor, determining that such relief was time-barred by 28 U.S.C. § 2462. On appeal, the Commission affirmed the ALJ's determination that Petitioners violated the Advisors Act. It also stiffened the sanctions imposed on the individual Petitioners by permanently barring them from associating with any investment advisor. *Ibid*.

The Commission explicitly rejected Petitioners' claims that each of its three sanctions—the associational bar, the cease-and-desist order, and disgorgement—were barred by § 2462. Opinion at 24-26. It conceded that "this proceeding was not brought within five years of the violations." *Id.* at 24. But it concluded that § 2462 applies only to "punitive" measures, and that the sanctions imposed on Petitioners were "equitable, not punitive." *Id.* at 25. It asserted that the associational bar and the cease-and-desist order were designed not to punish but to "protect investors" and "prevent future violations." *Id.* at 25-26. It asserted that disgorgement "simply restores the *status quo ante*" and "is inherently equitable (not punitive)." *Id.* at 26.

The Commission also rejected Petitioners' claims that entrusting substantial executive authority to ALJs who are protected by two layers of for-cause removal violated separation-of-powers principles enshrined in the U.S. Constitution. Order at 46-49. The Commission held that the Supreme Court's 2010 decision in *Free Enterprise Fund* (which determined that the structure of the Public Company Accounting Oversight Board (PCAOB) was unconstitutional) was distinguishable because ALJs are mere employees of the SEC and because "unlike the structure of the PCAOB, the ALJ system is not novel and has been in place for over 70 years." *Id.* at 48-49.

SUMMARY OF ARGUMENT

The SEC concedes that it instituted proceedings against Petitioners more than five years after the events giving rise to the proceedings. A federal statute bars any SEC "action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture," unless it is commenced within five years of the date on which the claim first accrued. 28 U.S.C. § 2462. Because the sanctions the SEC seeks to impose are properly classified as "penalties," "forfeitures," or both, they are barred by § 2462.

More than a century ago, the Supreme Court provided guidance regarding when a civil sanction should be deemed a penalty or forfeiture for purposes of § 2462's predecessor:

> The words "penalty or forfeiture" in this section refer to something imposed in a punitive way for an infraction of a public law, and do not include a liability imposed solely for the purpose of redressing a private injury, even though the wrongful act be a public offense, and punishable as such.

Meeker v. Lehigh Valley R. Co., 236 U.S. 412, 423 (1915). It is uncontested that no portion of the sanctions imposed by the SEC—the associational bars, the cease-and-desist order, and disgorgement—was imposed "for the purpose of redressing a private injury." Accordingly, those sanctions qualify as "penalties" and/or "forfeitures" within the meaning of § 2462.

The Supreme Court recently reiterated the broad scope of § 2462 in *Gabelli v. SEC*, 133 S. Ct. 1216 (2013). *Gabelli* rejected the SEC's efforts to apply a "discovery rule" to § 2462, such that an SEC claim would not accrue until the Commission "discovers" its cause of action. The Court ruled instead that an SEC claim "accrues when it comes into existence." *Id.* at 1220. It explained that its reading of "accrued" advances the "basic policies" of all statutes of limitations by setting a "fixed date" after which the threat of SEC enforcement ends, and thereby provides defendants with repose and certainty about their potential liability. *Ibid.* While some of this Court's pre-*Gabelli* decisions have adopted a more restrictive reading of § 2462, those decisions are no longer good law in light of *Gabelli*.

In rejecting Petitioners' § 2462 defense, the SEC argued that the sanctions it imposed were "equitable," not "punitive" in nature. The SEC's newly minted equitable/punitive distinction finds no support in the case law and makes very little sense. For one thing, the two categories are not mutually exclusive; many equitable remedies are designed to punish. More importantly, adopting the SEC's argument would eviscerate § 2462. The statute of limitations would cease to exist if the SEC could avoid the limitations of § 2462 any time it articulated an "equitable" rationale for imposing sanctions, and (as this case well illustrates) the SEC has little difficulty concocting such rationales.

The SEC's final opinion and order should also be vacated for the independent reason that the ALJ presiding over Timbervest's administrative proceeding is an inferior officer unconstitutionally insulated from removal by the President in violation of Article II. Like the Special Trial Judges held to be inferior officers in *Freytag v. Comm'r of Internal Revenue*, 501 U.S. 868 (1991), the SEC's ALJs all occupy an office that is "established by Law," exercise "significant authority" under federal law, and perform more than ministerial tasks in both overseeing and adjudicating administrative proceedings. Accordingly, the SEC's ALJs are executive officers for Article II purposes.

In *Free Enterprise Fund*, the Supreme Court held that where, as here, an executive officer can be removed from office only upon a showing of good cause, then the decision to remove that officer cannot be left to another official who is also shielded from removal by good-cause tenure protection. 561 U.S. at 484. Otherwise, the Court held, such "multilevel protection from removal" would impermissibly infringe upon the President's Article II duty to oversee the Executive power. Because the SEC's ALJs unquestionably enjoy precisely the same "multilevel protection from removal" at issue in *Free Enterprise Fund*, they operate outside the constraints of executive authority under Article II. The SEC's administrative proceeding against Timbervest thus violates the separation of powers and is unconstitutional.

ARGUMENT

I. THE SANCTIONS IMPOSED BY THE SEC ARE TIME-BARRED BY SECTION 2462

The SEC's administrative proceeding against Petitioners seeks sanctions against Petitioners under the Advisors Act, which makes it unlawful for an investment advisor "to employ any device scheme, or artifice to defraud any client or prospective 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), (2). Because the Advisors Act lacks a statute-specific limitations period, SEC proceedings under the Act are subject to the five-year statute of limitations imposed by 28 U.S.C. § 2462 on all proceedings "for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise."[2] *Gabelli*, 133 S. Ct. at 1219. Because the sanctions the SEC

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[2] The statute provides:

> Except as otherwise provided by Act of Congress, 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 if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

28 U.S.C. § 2462. The statute's origins date back to at least 1839, and its wording has been unchanged since 1948. *See* Act of Feb. 28, 1839, ch. 36, § 4, 5 Stat. 322.

seeks to impose against Petitioners qualify as "penalties," "forfeitures," or both, these proceedings are time-barred.

This Court held in *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996), that because the term "penalty" is not defined in § 2462, the term should be accorded its "ordinary, contemporary, common meaning." 87 F.3d at 487. "In common usage, a penalty is 'the suffering in person, rights, or property which is annexed by law or judicial decision to the commission of a crime or public offense.'" *Ibid* (quoting Webster's Third New International Dictionary 1668 (1976)).[3] The sanctions imposed on Petitioners—the associational bars, the cease-and-desist order, and the disgorgement order—fit comfortably within that definition. Each of those sanctions imposes "suffering" and "punishment" on Petitioners as a consequence for their alleged violations of the Advisors Act.

In construing § 2462 and its predecessor statutes, the Supreme Court has sought to distinguish between sanctions designed to punish the defendant and sanctions whose principal purpose is to provide compensation for individuals injured by the defendant's conduct. The former are "penalties" subject to § 2462's five-year limitations period; the latter are not:

[3] The Court also quoted the definition of "penalty" in Black's Law Dictionary 1020 (5th ed. 1979). *Johnson*, 87 F.3d at 487 (defining "penalty" as "A punishment imposed by statute as a consequence of the commission of an offense").

> The words "penalty or forfeiture" in this section refer to something imposed in a punitive way for an infraction of a public law, and do not include a liability imposed solely for the purpose of redressing a private injury, even though the wrongful act be a public offense, and punishable as such.

Meeker, 236 U.S. at 423.[4] It is undisputed that none of the sanctions imposed on Petitioners is designed to provide compensation to anyone who may have been injured by Petitioners' alleged misconduct. Accordingly, those sanctions qualify as "penalties" and/or "forfeitures" within the meaning § 2462. Indeed, this Court's decision in *Johnson* explicitly relied on *Meeker* in concluding that an associational bar imposed by the SEC was a "penalty" subject to § 2462's five-year limitations period. *Johnson*, 87 F.3d at 487-99 (citing *Meeker* for the proposition that "a 'penalty,' as the term is used in § 2462, is a form of punishment imposed by the government for unlawful or proscribed conduct, which goes beyond remedying the damage caused to the harmed party by the defendant's action.").[5]

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[4] *Meeker* held that sanctions imposed by the Interstate Commerce Commission against a railroad did not constitute a "penalty or forfeiture" within the meaning of § 2462's predecessor—Rev. Stat. § 1047, Comp. Stat. 1913, § 1712—because it was designed to provide compensation to a company that the railroad had overcharged for shipping coal. *Id.* at 423.

[5] In construing the term "penalty," *Johnson* also relied on a 19th-century Supreme Court decision that addressed when a judgment in a state court should be deemed "penal" for purposes of the Full Faith and Credit Clause:

> The Court explained that "[p]enal laws, strictly and properly, are those

In *Proffitt v. FDIC*, 200 F.3d 855 (D.C. Cir. 2000), the Court re-confirmed its definition of "a section 2462 penalty as a sanction used to punish an individual 'for unlawful or proscribed conduct, going beyond compensation of the wronged party.'" 200 F.3d at 860 (quoting *Johnson*, 87 F.3d at 491). The Court held that a sanction imposed by the FDIC—expulsion from the banking industry—was subject to § 2462's five-year limitation period because it went beyond "compensation of the wronged party." *Id.* at 861.

Because the SEC waited more than five years before initiating proceedings for the purpose of imposing sanctions on Petitioners that went "beyond compensation of the wronged party," these proceedings are time-barred.

A. *Gabelli* Confirms the Broad Reach of Section 2462

The SEC has long chafed at what it views as § 2462's overly restrictive limitations period. But rather than approaching Congress to amend the statute, it has urged courts to adopt a variety of measures designed to lengthen the limitations

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> imposing punishment for an offense committed against the state.... The test whether a law is penal, in the strict and primary sense, is whether the wrong sought to be redressed is a wrong to the public, or a wrong to the individual...." Put another way, the question is whether the law is penal depends on whether its purpose is "to punish an offense against the public justice of the State, or to afford a private remedy to a person injured by the wrong."

Id. at 253 (quoting *Huntington v. Attrill*, 146 U.S. 657, 667-68, 673-74 (1892)).

period. In particular, over the past several decades it has urged courts to adopt a "discovery" rule, under which § 2462's limitations period would not accrue until the SEC discovers, or with reasonable diligence should have discovered, the defendants' violations of the securities laws.

In *Gabelli*, the Supreme Court unanimously declined to adopt a discovery rule, holding instead that the § 2462 limitations period begins to run against the SEC as soon as the defendant completes the actions alleged to have violated the securities law. 133 S. Ct. at 1216. In rejecting the SEC's efforts to narrow the scope of § 2462, the Court repeatedly emphasized the broad reach of the statute of limitation. While the Court did not directly address § 2462's definition of a "penalty," language in the decision confirms the *Johnson*/*Proffitt* holding that the "penalty" analysis should focus on whether the SEC's sanctions go beyond remedying the damage caused to the harmed parties by the defendant's action.

For example, in rejecting the SEC's request for adoption of a discovery rule, the Court explained, "We have never applied the discovery rule in this context where the plaintiff is not a defrauded victim seeking recompense." *Id.* at 1221. The Court distinguished statutes cited by the SEC as examples of a discovery rule being applied to lawsuits filed by the government, noting that "in many of those instances, the Government is itself an injured victim looking for recompense, not a prosecutor seeking penalties." *Id.* at 1224. In other words, the Court was unwilling to relax the limitations imposed by § 2462 when the suit is one designed primarily to impose sanctions on the defendant, not to provide recompense for those injured by the defendant's conduct.

Gabelli also rejected a discovery rule because it determined that establishing a "fixed date" after which government enforcement efforts would be time-barred best served the purposes of statutes of limitations:

> This reading sets a fixed date when exposure to the specified Government enforcement efforts ends, advancing "the basic policies of all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities."

Id. at 1221 (quoting *Rotella v. Wood*, 528 U.S. 549, 555 (2000)). That language is an implicit rejection of the SEC's approach in this case. By here asserting that virtually all of its regularly employed sanctions are not subject to § 2462 without regard to whether they provide recompense to victims—and thus are not subject to *any* statute of limitations—the SEC is undercutting the purposes that, according to *Gabelli*, § 2462 was intended to serve.

In several pre-*Gabelli* panel decisions, this Court backed away from the reasoning of *Johnson* and *Proffitt* and held that SEC disgorgement and cease-and-desist orders are not subject to § 2462, despite the fact that such orders do not provide any recompense to alleged victims of the defendant. *See Riordan v. SEC*, 627 F.3d 1230 (D.C. Cir. 2010); *Zacharias v. SEC*, 569 F.3d 458 (D.C. Cir. 2009). In light of *Gabelli*, however, *Riordan* and *Zacharias* are no longer good law and need not be followed by this panel.

1. The Associational Bars Are Penalties

As a sanction for violating the Advisors Act, the SEC permanently barred the four individual Petitioners from associating with any investment advisors. In other words, they are permanently barred from pursuing a livelihood in their chosen profession. *Johnson* and *Proffitt* held categorically that such associational bars are penalties subject to § 2462. The SEC has repeatedly stated that it does not agree with the *Johnson* decision. Its imposition of associational bars on Petitioners is simply an open defiance of *Johnson* and should be reversed.

The SEC asserts that "barring the Timbervest partners from associating with an investment advisor is not 'punishment' nor is it 'punitive' because such bars protect investors from unfit professionals." Opinion at 25. That assertion is without merit. It may be that the SEC is acting in part to protect the public from Petitioners, but the SEC's assertion is irrelevant to the statutory question at issue here: whether the associational bar is a sanction designed to recompense victims of Petitioners' past misconduct. As *Johnson* explained in rejecting the very argument being asserted here:

> In interpreting § 2462, however, the court's concern is not whether Congress legislated the sanction as part of a regulatory scheme to protect the public, but rather whether the sanction is itself a form of punishment of the individual for unlawful or prescribed conduct, going beyond compensation of the wronged party.

Johnson, 87 F.3d at 491. *Johnson* held that associational bars imposed as a sanction in connection with an SEC enforcement proceeding are a form of punishment and thus are subject to § 2462. *Ibid.*

This is not to say that governments may not adopt valid licensing schemes for professionals and deny licenses to individuals deemed to lack the necessary qualifications. But the SEC does not operate a licensing system for investment advisors. Instead, it is attempting to impose an associational bar based to a significant extent on an administrative finding that Petitioners violated the Advisors Act. It is prohibited from doing so by § 2462 when, as here, it did not initiate proceedings until more than five years after the violations.

2. Cease-and-Desist Orders Are Penalties

Cease-and-desist orders fall within the ambit of § 2462 for the same reason that associational bars do: they are not designed to recompense victims of the defendant's misconduct. It is simply not relevant to the punishment/remediation distinction whether, as the SEC asserts, cease-and-desist orders are also designed "to protect the public by preventing future violations." Opinion at 26.

Johnson explained that an important factor in determining whether a sanction can be deemed a "penalty" is whether the sanction has "collateral consequences" for the defendant. 87 F.3d at 489. Petitioners have explained at length in their brief that, quite apart from the associational bar, the cease-and-desist order will have very significant collateral consequences. As they explain, the order will make it virtually impossible for the individual Petitioners to continue to manage their existing funds.

Gabelli eliminates any doubt about the punishment-like qualities of the cease-and-desist order. In explaining its rationale for limiting the discovery rule to cases involving individuals seeking to recover damages, the Court stated:

> The discovery rule helps to ensure that the injured receive recompense. But this case involves penalties, which go beyond compensation, are intended to punish, and *label defendants wrongdoers*.

Gabelli, 133 S. Ct. at 1223 (emphasis added) (citing *Meeker*, 236 U.S. at 423). That statement makes plain that sanctions, such as cease-and-desist orders, that "label defendants wrongdoers" are "penalties" within the meaning of § 2462.

The Court, in its pre-*Gabelli* decision in *Riordan*, concluded that cease-and-desist orders are not subject to § 2462's five-year limitations period. *Riordan*, 627 F.3d at 1234. But the Court's analysis of the issue was limited to a single sentence: "[The cease-and-desist order] simply requires Riordan not to violate the relevant securities laws in the future." *Ibid.* Particularly given that *Riordan* failed to examine the numerous collateral consequences of a cease-and-desist order, its holding does not survive *Gabelli*'s contrary conclusions.

3. Disgorgement Is Both a Penalty and a Forfeiture

The SEC ordered Petitioners to disgorge allegedly ill-gotten gains. The SEC does not contend that the disgorgement remedy is designed to create a fund from which any victims of Petitioners' misconduct can obtain compensation. Rather, it justifies the sanction as an effort to "restore[ ] the *status quo ante*" by depriving Petitioners of fees that they allegedly did not properly earn. Opinion at 26.

Disgorgement orders fall within the ambit of § 2462 for the same reason that associational bars do: they are not designed to recompense victims of the defendant's misconduct. The fact that they are designed to deprive defendants of ill-gotten gains does not make them any less a "penalty" within the meaning of § 2462.

The Court's contrary holding in *Zacharias v. SEC* did not survive *Gabelli* and thus is not binding on this panel. *Gabelli* made clear that the § 2462 "penalty" analysis should focus on whether SEC's sanctions go beyond remedying the damage caused to the harmed parties by the defendant's action. 133 S. Ct. at 1221, 1223, 1224. Because disgorgement does not provide recompense to harmed parties, it qualifies as a "penalty."

Zacharias relied on *Johnson* (which first introduced the "*status quo ante*" language) for the proposition that disgorgement is not a penalty. *Zacharias*, 569 F.3d at 471 (stating that "disgorgement restores the *status quo ante* by depriving violators of ill-gotten gains"). That reliance was misplaced. Properly understood, *Johnson* stated no more than that a SEC sanction is not a "penalty" when it restores *the victim* to the *status quo ante*. *Johnson*, 84 F.3d at 491. Attributing a broader meaning to *Johnson*'s "*status quo ante*" reference would be wholly inconsistent with *Johnson*'s definition of a "penalty": "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." *Id*. at 488. Indeed, *Zacharias*'s rationale would justify excluding virtually all monetary sanctions from the definition of "penalty"—given that most securities law violators have profited from their wrongdoing, and thus that any monetary sanction would serve to restore the *status quo ante*.

Zacharias also relied on several decisions holding that an "order to disgorge is not a punitive measure; it is intended primarily to prevent unjust enrichment." *Zacharias*, 569 F.3d at 471 (quoting *SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000)). But those decisions did not arise in the § 2462 context and did not examine on which side of the punishment/remediation dividing line a disgorgement order falls. To be clear: WLF does not question the holdings of the disgorgement case law cited by *Zacharias* or that the SEC is authorized to seek disgorgement of ill-gotten gains from those who violate the securities law. However, as *Johnson* and *Gabelli* make clear, the SEC loses that authority if it waits more than five years to initiate an enforcement action.

B. The SEC's Effort to Distinguish Equitable Sanctions from Punitive Sanctions Lacks a Statutory Basis

This case well illustrates what has become a pattern with the SEC: it regularly comes up with new theories for restricting the scope of § 2462 after previous theories have been rejected by the courts. Its latest theory: the sanctions it seeks against Petitioners are not "penalties" because they are "equitable" in nature.[6] Order at 25. The SEC's newly minted equitable/punitive distinction finds no support in the case law. As *Meeker* and *Johnson* make clear, the only relevant inquiry is whether the sanction is remedial, not whether it is equitable.

For one thing, the two categories (equitable and punitive) are not mutually

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[6] The inventive "equitable" theory comes on the heels of the SEC's defeat in *Gabelli*, which rejected the SEC's "discovery rule" theory. A previous example of the SEC's "discovery" of new limitations on the scope of § 2462 is recounted in *Johnson*. The SEC's initial position in that case was that § 2462 applied only to *judicial* proceedings, not SEC administrative proceedings. After the Commission issued its initial decision in the case, this Court's decision in *3M Company v. Browner*, 17 F.3d 1453 (D.C. Cir. 1994), rejected the "judicial proceedings" argument. At that point, the SEC shifted gears and began arguing that the associational bar at issue in *Johnson* was not a "penalty" within the meaning of § 2462. *See Johnson*, 87 F.3d at 486.

exclusive; many equitable remedies are penal in nature. For example, the associational bar that the SEC seeks to impose on the individual Petitioners is an equitable remedy. *Johnson* nonetheless held that associational bars are "penalties" and thus subject to § 2462's five-year limitations period.

More importantly, adopting the SEC's argument would eviscerate § 2462. The statute of limitations would cease to exist if the SEC could avoid § 2462 limitations any time it articulated an "equitable" rationale for imposing sanctions, and (as this case well illustrates) the SEC has little difficulty concocting such rationales. The SEC seeks to distinguish *Johnson* by asserting that it is imposing associational bars because they are necessary to "protect investors in the future from unfit professionals." Opinion at 25. But that "equitable" rationale proves too much. It could be asserted with respect to anyone who has been found to have violated the securities laws.

Moreover, the SEC's position that § 2462 is inapplicable to three commonly employed sanctions—associational bars, cease-and-desist orders, and disgorgement orders—effectively means that there is *no* limitations period on agency proceedings to impose such sanctions. This Court in *3M Company* rejected a limiting interpretation of § 2462 in large measure because the Court found it "inconceivable" that Congress intended to grant administrative agencies a perpetual right to initiate enforcement proceedings based on long-past violations. *3M Company*, 17 F.3d at

1459. The Court supported its conclusion by quoting Chief Justice Marshall's famous paean to statutes of limitations: "In a country where not even treason can be prosecuted, after a lapse of three years, it could scarcely be supposed that an individual would remain for ever liable to a pecuniary forfeiture." *Id.* at 1457 (quoting *Adams v. Woods*, 6 U.S. (2 Cranch) 336, 341 (1805)).

Similarly, the Court should presume that Congress did not intend to permit the SEC to avoid all limitations on its enforcement actions simply by labeling them "equitable" in nature.

II. THE SEC'S ADMINISTRATIVE PROCEEDING IN THIS CASE IS UNCONSTITUTIONAL BECAUSE THE ALJ'S DUAL LAYER OF GOOD-CAUSE TENURE PROTECTION VIOLATES THE SEPARATION OF POWERS

The Constitution divides federal powers among three co-equal branches: Legislative, Executive, and Judicial. The Framers implemented the tripartite separation of powers "to provide avenues for the operation of checks on the exercise of governmental power." *Bowsher v. Synar*, 478 U.S. 714, 722 (1986). To help accomplish that important aim, the Constitution vests the executive power in the President, who must "take Care that the Laws be faithfully executed." U.S. Const. Art. II, § 3. Because "[t]he President cannot 'take Care that the Laws be faithfully executed' if he cannot oversee the faithfulness of the officers who execute them," *Free Enter. Fund*, 561 U.S. at 484, any restriction on the President's removal power is presumptively unconstitutional. *See*, *e.g.*, *Myers v. United States*, 272 U.S. 52, 134 (1926) (explaining that the President "must have the power to remove [executive officers] without delay").

In *Free Enterprise Fund*, the Supreme Court held that where, as here, an executive officer can be removed from office only upon a showing of good cause, then the decision to remove that officer cannot be left to another official who is also shielded from removal by good-cause tenure protection. 561 U.S. at 484. Otherwise, the Court held, such "multilevel protection from removal" would impermissibly infringe upon the President's Article II duty to oversee the executive power. *Ibid.* As shown below, because the SEC's ALJs enjoy precisely the same "multilevel protection from removal" at issue in *Free Enterprise Fund*, they operate outside the constraints of executive authority under Article II. Accordingly, the SEC's administrative proceeding against Timbervest violates the separation of powers and is unconstitutional.

A. The SEC's ALJs Are Inferior Officers of the United States

Where, as here, an individual "exercise[s] significant authority pursuant to the laws of the United States," that person "is an Officer of the United States." *Buckley v. Valeo*, 424 U.S. 1, 126 (1976). Indeed, an SEC ALJ is similar in all relevant respects to the Special Trial Judges (STJs) held by the Supreme Court to be inferior officers in *Freytag v. Commissioner of Internal Revenue*. 501 U.S. at 868. In so holding, the Court focused on (1) the fact that the office of the STJ was "established by Law ... and the duties, salary, and means of appointment for that office [were] specified by statute," and (2) that the STJs performed "more than ministerial tasks." 501 U.S. at 881-82. The SEC's ALJs resemble STJs in both respects.

As was the case for the STJs in *Freytag*, the office of an ALJ in the SEC is established by law. The SEC's ALJs' duties, salary, and means of appointment are all established by statute. *See, e.g.*, 5 U.S.C. § 556 (establishing powers and duties of ALJs presiding over administrative hearings); 5 U.S.C. § 557(b) (providing that an ALJ shall "initially decide the case"); 5 U.S.C. § 5372 (establishing the salary of ALJs); 5 U.S.C. § 3105 ("Each agency shall appoint as many [ALJs] as are necessary for the proceedings required to be conducted in accordance with sections 556 and 557 of this title").

Entrusted with broad authority, the SEC's ALJs perform more than mere "ministerial tasks." Identical to the STJs in *Freytag*, the SEC's ALJs regularly take testimony, conduct trials, make evidentiary rulings, and impose sanctions. *See, e.g.*, 17 C.F.R. § 200.14 (establishing an ALJ's broad powers in proceedings instituted by the SEC); 17 C.F.R. § 200.30-9 (describing the delegation of significant authority from the SEC to each ALJ "hearing officer"); 17 C.F.R. § 200.30-10 (describing the delegation of authority from the SEC to the Chief ALJ); 17 C.F.R. § 200.111 (establishing the authority of a "hearing officer"); 17 C.F.R. § 201.180 (authorizing the ALJ to impose sanctions for contemptuous conduct). Indeed, the fact that the SEC authorizes its ALJs to "[r]egulate the course of a hearing," 17 C.F.R. § 200.14, confirms that they exercise "significant discretion" in "carrying out the[ir] important functions." *Freytag*, 501 U.S. at 882.

Although *Freytag* did not squarely address whether ALJs constitute inferior officers of the United States, Justice Scalia answered this question in the affirmative in his concurring opinion, concluding that ALJs "are all *executive* officers." 501 U.S. at 910 (Scalia, J., concurring in part and concurring in judgment, joined by O'Connor, Kennedy, & Souter, JJ.) (emphasis in original). Justice Breyer later embraced that same view in his dissent in *Free Enterprise Fund*. *See* 561 U.S. at 542 (Breyer, J., dissenting, joined by Stevens, Ginsburg, & Sotomayor, JJ.) ("As Justice Scalia has observed, 'administrative law judges (ALJs) are all executive officers.'").

B. The SEC's ALJs Are *Not* Mere Employees

Insisting that its ALJs are merely low-level "employees," the SEC contends that holding a hearing before an ALJ is both constitutional and consistent with statute. But the SEC fails even to recite the applicable statutory language that serves as the basis for such a hearing in this case, § 12 of the Advisors Act. That provision, entitled

"Hearings," expressly states that "Hearings ... may be held before the Commission, any member or members thereof, or *any officer or officers of the Commission designated by it* ...." 15 U.S.C. § 80b-12 (emphasis added).[7] On its face, this statutory language confirms that only someone who is an officer of the SEC may be designated to hold hearings under the Advisors Act. And the fact that a hearing officer is statutorily interchangeable with either the SEC itself or a commissioner of the SEC confirms that a hearing officer is someone who enjoys the broad discretion of an executive officer, *i.e.*, an officer empowered to "exercise significant authority pursuant to the laws of the United States." *Free Enter. Fund*, 561 U.S. at 486 (citing *Buckley*, 424 U.S. at 126).

This statutory language is instructive because the manner in which the SEC has interpreted it until recently shows that the SEC views those whom it empowers to exercise the significant investigatory powers of the SEC as "officers"—*not* "employees." Indeed, the SEC's own enforcement manual designates as "senior officers" those who are empowered "to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of

[7] Nor is the Advisors Act alone in requiring that hearings be conducted by the Commission or "any other officer or officers of the Commission designated by it." Indeed, all of the major statutes enforced by the SEC have substantially the same language. *See* 15 U.S.C. § 78v (Securities Exchange Act of 1934); 15 U.S.C. § 77u (Securities Act of 1933); 15 U.S.C. § 80a-40 (Investment Company Act of 1940).

documents and other materials" in the course of formal investigative proceedings. *See* SEC Office of Chief Counsel, Enforcement Manual § 2.3.4 (June 4, 2015).

The SEC also claims that its ALJs are employees under this Court's holding in *Landry v. FDIC*, 204 F.3d 1125, 1133-34 (D.C. Cir. 2000), which concluded that the FDIC's ALJs were not executive officers. But this argument misses the mark because, as the Solicitor General explained in opposing Landry's petition for certiorari, this Court "did not purport to establish any categorical rule that administrative judges are employees rather than 'inferior officers.'" U.S. Br. Opposing Cert., *Landry*, No. 99-1916, 2000 WL 34013905, at *7 (U.S. Aug. 28, 2000). Rather, this Court's *Landry* holding was limited to evaluating the particular role and duties of the FDIC's ALJs.

Nor should this Court accept the SEC's characterization of *Freytag* as somehow turning on whether an STJ could render a final decision of the Tax Court. On the contrary, as Judge Randolph emphasized in his concurrence in *Landry*, the Supreme Court in *Freytag* clearly designated the potential finality of an STJ's decision as an additional, *alternative* basis for its holding that STJs were officers. *See* 204 F.3d at 1142 (Randolph, J., concurring in part and concurring in judgment) (explaining that *Freytag* "clearly designated [an STJ's power to render a final decision] as an alternative holding" to the "conclusion it had reached in the preceding paragraphs—namely ... [STJs] are nevertheless inferior officers of the United States").

And *un*like the FDIC's ALJs at issue in *Landry*, the SEC's ALJs may render a final decision of the SEC under certain circumstances. *See* 5 U.S.C. § 557(b) (explaining that when an ALJ "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 the time provided by the rule").[8] Accordingly, the SEC's ALJs much more closely resemble the STJs in *Freytag* than the ALJs in *Landry*.

C. The SEC's ALJs are Insulated from Removal by Two Layers of Good-Cause Tenure Protection

It is undisputed in this case that two layers of tenure protection shield the SEC's ALJs from the President's removal. The SEC's ALJs are not only appointed for life but are removable "only for good cause established and determined by the Merit Systems Protection Board." 5 U.S.C. §§ 7521(a)-(b). Yet the members of the Merit Systems Protection Board, who determine whether sufficient "good cause" exists to remove an ALJ, are themselves protected from removal by the President absent "inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d). Thus, the

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[8] To the best of WLF's knowledge, *every* court to consider the question has squarely rejected the SEC's position that its ALJs are not officers but mere employees. *See Ironridge Glob. IV, Ltd. v. SEC*, 1:15-cv-2512, 2015 WL 7273262 (N.D. Ga. Nov. 17, 2015); *Duka v. SEC*, 124 F. Supp. 3d 287 (S.D.N.Y. 2015); *Gray Fin. Grp., Inc. v. SEC*, 1:15-cv-492 (N.D. Ga. Aug. 4, 2015); *Timbervest, LLC v. SEC*, 1:15-cv-2106, 2015 WL 7597428 (N.D. Ga. Aug. 4, 2015); *Hill v. SEC*, 114 F. Supp. 3d 1297 (N.D. Ga. June 8, 2015).

SEC's ALJs, who are inferior officers of the United States, are impermissibly insulated from removal by two layers of good-cause tenure protection.

Such a structure "not only protects [the SEC's ALJs] from removal for good cause, but withdraws from the President any decision on whether that good cause exists." *Free Enter. Fund*, 561 U.S. at 495. "Neither the President, nor anyone directly responsible to him, nor even an officer whose conduct he may review only for good cause, has full control over" the agency's ALJs. *Id.* at 496. Yet to "ensure that those who wiel[d]" power are "accountable to political force and the will of the people," *Freytag*, 501 U.S. at 884, the President must retain some "power of removing those for whom he cannot continue to be responsible." *Myers v. United States*, 272 U.S. 52, 117 (1926).

In sum, because the ALJ presiding over Timbervest's proceeding below is protected from removal by dual layers of tenure, which impermissibly impair the President's ability to ensure that the laws are faithfully executed, that arrangement is contrary to Article II. Such a constitutional defect "goes to the validity of the ... proceeding," *Freytag*, 501 U.S. at 879, and this Court should vacate the SEC's final opinion and order in this case.

CONCLUSION

WLF respectfully requests that the Court vacate the Opinion and Order of the Securities and Exchange Commission.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I am an attorney for *amicus curiae* Washington Legal Foundation. Pursuant to Fed.R.App.P. 32(a)(7)(C), I hereby certify that the foregoing brief of *amicus curiae* is in 14-point, proportionately spaced Times New Roman type. According to the word processing system used to prepare this brief (WordPerfect X5), the word count of the brief is 6,929, not including the certificate as to parties, table of contents, table of authorities, glossary, certificate of service, and this certificate of compliance.

/s/ Richard A. Samp
Richard A. Samp

April 29, 2016

CERTIFICATE OF SERVICE

I hereby certify that on April 29, 2016, I electronically filed the brief of *amicus curiae* Washington Legal Foundation with the Clerk of the Court of the U.S. Court of Appeals for the District of Columbia Circuit by using the appellate CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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