No. 17-475

In the Supreme Court of the United States

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

DAVID F. BANDIMERE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether administrative law judges of the Securities and Exchange Commission, who act as hearing officers in administrative proceedings, are inferior officers under the Appointments Clause, U.S. Const. Art. II, § 2, Cl. 2.

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PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the Securities and Exchange Commission, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-67a) is reported at 844 F.3d 1168. The order of the court of appeals denying panel rehearing and rehearing en banc (App., *infra*, 157a-168a) is reported at 855 F.3d 1128. The decision and order of the Securities and Exchange Commission (App., *infra*, 70a-156a) are not yet reported but are available at 2015 WL 6575665.

JURISDICTION

The judgment of the court of appeals was entered on December 27, 2016. A petition for rehearing was denied on May 3, 2017 (App., *infra*, 157a-158a). On July 24, 2017, Justice Sotomayor extended the time within which

to file a petition for a writ of certiorari to and including August 31, 2017. On August 22, 2017, Justice Sotomayor further extended the time within which to file a petition for a writ of certiorari to and including September 29, 2017. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Appointments Clause of the Constitution (Art. II, § 2, Cl. 2) provides:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Section 3105 of Title 5 of the United States Code provides:

> Each 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. Administrative law judges shall be assigned to cases in rotation so far as practicable, and may not perform duties inconsistent with their duties and responsibilities as administrative law judges.

STATEMENT

1. Congress has created a comprehensive scheme for the commencement, adjudication, and judicial review of proceedings brought by the Securities and Exchange Commission (SEC or Commission) to enforce the Nation's securities laws. As relevant here, the Commission is authorized under the Securities Act of 1933, 15 U.S.C. 77a *et seq.*, the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*, the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, and the Investment Advisers Act of 1940, 15 U.S.C. 80b-1 *et seq.*, to address statutory violations by instituting administrative proceedings before the agency. See, *e.g.*, 15 U.S.C. 77h-1, 78d, 78*o* (2012 & Supp. III 2015), 78u-3, 80a-9(b), 80a-41(a), 80b-3(e), (f), and (k).

In an administrative enforcement proceeding, the Commission itself may preside and issue a final decision. 17 C.F.R. 201.110. In the alternative, Congress has authorized the Commission to delegate "its functions to a division of the Commission, an individual Commissioner, an administrative law judge, or an employee or employee board." 15 U.S.C. 78d-1(a). Exercising this authority, the Commission has provided by rule that it may delegate the initial stage of conducting an enforcement proceeding to a "hearing officer." 17 C.F.R. 201.110. The hearing officer may be an administrative law judge (ALJ) appointed under 5 U.S.C. 3105, a single Commissioner, multiple Commissioners (short of a quorum of the Commission), or "any other person duly authorized to preside at a hearing." 17 C.F.R. 201.101(a)(5).

The Commission historically has chosen to assign ALJs to act as hearing officers in its proceedings. 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," which are provisions governing agency hearings. See 5 U.S.C. 556, 557. The Commission currently employs five ALJs, which are hired "through a merit-selection process administered by the Office of Personnel Management." App., *infra*, 15a.[1] The Commission's ALJs are selected by its Chief ALJ, subject to approval by the Commission's Office of Human Resources on the exercise of delegated authority from the Commission. See *ibid.*; cf. 15 U.S.C. 78d(b)(1) (Commission's authority to "appoint and compensate officers, attorneys, economists, examiners, and other employees").

An ALJ who acts as a hearing officer in an SEC enforcement proceeding generally has a specified number of days in which to issue an "initial decision." 17 C.F.R. 201.360. The ALJ's initial decision may be reviewed by the Commission on its own initiative or at the request of a party or other aggrieved person, 17 C.F.R. 201.410, 201.411(c), and that review is *de novo*. The Commission also may take additional evidence itself, 17 C.F.R. 201.452, and may "make any findings or conclusions that in its judgment are proper and on the basis of the record," 17 C.F.R. 201.411(a). Regardless whether a party seeks the full Commission's review of an initial decision, no sanction ordered by an ALJ may take effect unless the Commission itself issues a final order. 17 C.F.R. 201.360(d).

A respondent who is aggrieved by a final order of the Commission may seek judicial review of that order by

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[1] See Office of Personnel Mgmt., *ALJs by Agency*, https://www.opm.gov/services-for-agencies/administrative-law-judges/#url=ALJs-by-Agency.

filing a petition for review directly in a federal court of appeals. See 15 U.S.C. 77i(a), 78y(a)(1), 80a-42(a), 80b-13(a).

2. In 2012, the SEC initiated an administrative proceeding against respondent, alleging violations of federal securities laws. App., *infra*, 2a. The Commission assigned an ALJ to preside over the initial stages of the administrative proceeding. *Id.* at 2a-3a. The ALJ issued an initial decision concluding that respondent had violated antifraud and registration provisions of the federal securities laws by operating as an unregistered broker and by failing to disclose potentially negative facts to investors. *Id.* at 72a.

On review of the ALJ's initial decision, the Commission conducted "an independent review of the record, except with respect to those findings not challenged on appeal." App., *infra*, 72a. The Commission found that respondent had violated federal securities laws, and it imposed disgorgement and civil penalty sanctions. *Ibid.* The Commission did not accept, however, the ALJ's recommendation that respondent's future activities should be subject to an industry-wide bar, and it instead imposed a more limited bar. *Id.* at 143a-145a.

Respondent argued to the Commission that the ALJ who had rendered the initial decision in his proceeding was acting as an "inferior officer" within the meaning of the Appointments Clause, U.S. Const. Art. II, § 2, Cl. 2, and that the ALJ had not been properly appointed under that Clause. App., *infra*, 3a. The Commission rejected that argument and concluded instead that its ALJs are agency employees, not inferior officers. Citing the D.C. Circuit's analysis in *Landry* v. *FDIC*, 204 F.3d 1125, cert. denied, 531 U.S. 924 (2000), which rejected an Appointments Clause challenge to the use of

ALJs by the Federal Deposit Insurance Corporation (FDIC), the Commission concluded that SEC ALJs, because they do not render final decisions or issue findings to which the Commission is required to defer, are employees rather than constitutional officers. App., *infra*, 121a-128a.

3. A divided panel of the court of appeals granted respondent's petition for review and set aside the Commission's decision. App., *infra*, 1a-67a. The court held that the ALJ who had presided over respondent's administrative hearing had exercised powers that required appointment as an "inferior Officer" under the Appointments Clause. For that conclusion, the majority relied on *Freytag* v. *Commissioner*, 501 U.S. 868 (1991), which held that special trial judges of the Tax Court are inferior officers. See App., *infra*, 10a ("*Freytag* controls the result of this case."). The majority opined that the determination in *Freytag* had turned not on the special trial judges' authority to render final decisions of the Tax Court in certain circumstances, as the D.C. Circuit had reasoned in *Landry*, but rather on the significance of the authority that special trial judges exercised: in taking testimony, conducting trials, ruling on the admissibility of evidence, and enforcing compliance with discovery orders. *Id.* at 25a-31a. The majority concluded that "SEC ALJs exercise significant discretion in performing 'important functions' commensurate with the [special trial judges'] functions described in *Freytag*." *Id.* at 20a (quoting *Freytag*, 501 U.S. at 882); see *id.* at 20a-25a. The majority also determined that the "error here is structural," such that respondent did not "need to show prejudice" to prevail. *Id.* at 24a n.31.

Judge McKay dissented. App., *infra*, 51a-67a. In his view, *Freytag* did not "mandate[] the result proposed here." *Id.* at 51a. Unlike SEC ALJs, he reasoned, the special trial judges at issue in *Freytag* could enter final decisions in a number of cases; and even where they could not, "the Tax Court was required to defer to its special trial judges' findings." *Id.* at 58a. By contrast, in his view, SEC ALJs "possess only a 'purely recommendatory power.'" *Id.* at 59a (quoting *Landry*, 204 F.3d at 1132).

4. The court of appeals denied the government's petition for rehearing. App., *infra*, 157a-158a. Judge Lucero, joined by Judge Moritz, dissented from the denial of rehearing en banc. *Id.* at 159a-168a.

ARGUMENT

1. The courts of appeals are divided over the question whether administrative law judges who act as hearing officers in SEC enforcement proceedings are inferior officers who must be appointed in accordance with the Appointments Clause. In the proceeding below, a divided panel of the Tenth Circuit held that SEC ALJs are inferior officers. The D.C. Circuit reached the opposite conclusion under materially identical circumstances in *Raymond J. Lucia Cos.* v. *SEC*, 832 F.3d 277 (2016) (*Lucia*).

In *Lucia*, an SEC ALJ issued an initial decision finding that Raymond Lucia and his investment advisory firm (collectively, Lucia) had violated the anti-fraud provisions of the Investment Advisers Act of 1940. 832 F.3d at 282-283. The Commission *sua sponte* remanded the case to the ALJ for additional findings of fact, and the ALJ issued a revised initial decision. *Id.* at 283. On further review, the Commission found that Lucia had violated the Investment Advisers Act and ordered various

remedies. *Ibid.* The Commission also rejected Lucia's contention that the ALJ who presided over the initial hearing was not properly appointed under the Appointments Clause. *Ibid.*

A panel of the D.C. Circuit denied Lucia's petition for review, holding that the Commission's ALJs are employees, not constitutional officers, because they do not exercise significant authority in their own right. *Lucia*, 832 F.3d at 284-285 (citing *Buckley* v. *Valeo*, 424 U.S. 1, 126 (1976) (per curiam)). The court of appeals rejected Lucia's efforts to distinguish the court's earlier decision in *Landry*, finding no constitutionally meaningful distinctions between the roles of SEC ALJs and the FDIC ALJs at issue in *Landry*. *Id.* at 287. The court thus concluded that SEC ALJs are not constitutional officers because "the Commission's ALJs neither have been delegated sovereign authority to act independently of the Commission nor, by other means established by Congress, do they have the power to bind third parties, or the government itself, for the public benefit." *Id.* at 286.

The D.C. Circuit granted Lucia's petition for rehearing en banc. On June 27, 2017, the en banc court issued a per curiam judgment denying the petition for review by an equally divided vote. No. 15-1345, 2017 WL 2727019. On July 21, 2017, Lucia filed a petition for a writ of certiorari. See *Lucia* v. *SEC*, No. 17-130. A number of other cases pending before the courts of appeals also include Appointments Clause challenges to SEC ALJs.[2]

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[2] See *Gonnella* v. *SEC*, No. 16-3433 (2d Cir. filed Oct. 7, 2016); *Bennett* v. *SEC*, Nos. 16-3827, 16-3830 (8th Cir. filed Oct. 3, 2016); *J.S. Oliver Capital Mgmt.* v. *SEC*, No. 16-72703 (9th Cir. filed Aug. 15, 2016); *Feathers* v. *SEC*, No. 15-70102 (9th Cir. filed Jan. 12, 2015); *Bennett* v. *SEC*, No. 17-9524 (10th Cir. filed May 22, 2017); *Timbervest* v. *SEC*, No. 15-1416 (D.C. Cir. filed Nov. 13, 2015);

2. The Appointments Clause question at issue in this case and in *Lucia* warrants review by this Court. The Court may wish, however, to consider that question in *Lucia*, because the government's petition for rehearing en banc in this case was filed in the court of appeals while Justice Gorsuch was a member of that court. The government's response to the certiorari petition in *Lucia* is currently due on October 25, 2017. The government intends to address more fully in its response to the petition in *Lucia* why the Court should review the Appointments Clause question presented here.

We therefore respectfully request that the Court hold this petition pending its consideration of the petition in *Lucia*. If the Court grants the petition in *Lucia*, the government suggests that the Court hold the petition in this case pending the final disposition of *Lucia*. If the Court denies the petition in *Lucia*, it should deny the petition in this case as well.

Young v. *SEC*, No. 16-1149 (D.C. Cir. filed May 24, 2016); *Riad* v. *SEC*, No. 16-1275 (D.C. Cir. filed Aug. 4, 2016); *The Robare Grp., Ltd.* v. *SEC*, No. 16-1453 (D.C. Cir. filed Dec. 27, 2016). A panel of the Fifth Circuit recently granted a stay of an FDIC order in an analogous case, expressly disagreeing with the D.C. Circuit's decision in *Landry* and concluding that the respondent had established a likelihood of success on his claim that the ALJ who presided over his proceeding was not properly appointed under the Appointments Clause. *Burgess* v. *FDIC*, No. 17-60579, 2017 WL 3928326 (5th Cir. Sept. 7, 2017).

CONCLUSION

The petition for a writ of certiorari should be held pending this Court's consideration of the petition for a writ of certiorari in *Lucia* v. *SEC*, No. 17-130, and then disposed of as appropriate.

Respectfully submitted.

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SEPTEMBER 2017

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 15-9586

DAVID F. BANDIMERE, PETITIONER

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

IRONRIDGE GLOBAL IV, LTD;
IRONRIDGE GLOBAL PARTNERS, LLC, AMICI CURIAE

[Filed: Dec. 27, 2016]

PETITION FOR REVIEW OF AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION (SEC No. 3-15124)

Before BRISCOE, MCKAY, and MATHESON, Circuit Judges.

MATHESON, Circuit Judge.

When the Framers drafted the Appointments Clause of the United States Constitution in 1787, the notion of administrative law judges ("ALJs") presiding at securities law enforcement hearings could not have been contemplated. Nor could an executive branch made

up of more than 4 million people,[1] most of them employees. Some of them are "Officers of the United States," including principal and inferior officers, who must be appointed under the Appointments Clause. U.S. Const. art. II, § 2, cl. 2. In this case we consider whether the five ALJs working for the Securities and Exchange Commission ("SEC") are employees or inferior officers.

Based on *Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868 (1991), we conclude the SEC ALJ who presided over an administrative enforcement action against Petitioner David Bandimere was an inferior officer. Because the SEC ALJ was not constitutionally appointed, he held his office in violation of the Appointments Clause. Exercising jurisdiction under 15 U.S.C. §§ 77i(a) and 78y(a)(1), we grant Mr. Bandimere's petition for review.

I. BACKGROUND

The SEC is a federal agency with authority to bring enforcement actions for violations of federal securities laws. 15 U.S.C. §§ 77h-1, 78d, 78*o*, 78u-3. An enforcement action may be brought as a civil action in federal court or as an administrative action before an ALJ. In 2012, the SEC brought an administrative action against Mr. Bandimere, a Colorado businessman, alleging he violated various securities laws. An SEC ALJ presided over a trial-like hearing. The ALJ's initial

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[1] Office of Pers. Mgmt., Historical Federal Workforce Tables, https://perma.cc/LZ7P-EPAG. The first census in 1790 counted 3.9 million inhabitants in the United States. U.S. Census Bureau, 1790 Overview, https://perma.cc/EYF2-4K2L. The Perma.cc links throughout this opinion archive the referenced webpages.

decision concluded Mr. Bandimere was liable, barred him from the securities industry, ordered him to cease and desist from violating securities laws, imposed civil penalties, and ordered disgorgement. David F. Bandimere, SEC Release No. 507, 2013 WL 5553898, at *61-84 (ALJ Oct. 8, 2013).

The SEC reviewed the initial decision and reached a similar result in a separate opinion. David F. Bandimere, SEC Release No. 9972, 2015 WL 6575665 (Oct. 29, 2015). During the SEC's review, the agency addressed Mr. Bandimere's argument that the ALJ was an inferior officer who had not been appointed under the Appointments Clause. *Id.* at *19. The SEC conceded the ALJ had not been constitutionally appointed, but rejected Mr. Bandimere's argument because, in its view, the ALJ was not an inferior officer. *Id.* at *19-21.

Mr. Bandimere filed a petition for review with this court under 15 U.S.C. §§ 77i(a) and 78y(a)(1), which allow an aggrieved party to obtain review of an SEC order in any circuit court where the party "resides or has his principal place of business." In his petition, Mr. Bandimere raised his Appointments Clause argument and challenged the SEC's conclusions regarding securities fraud liability and sanctions.[2]

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[2] Other SEC respondents have attacked the validity of SEC ALJs by filing collateral lawsuits attempting to enjoin administrative enforcement actions. Circuit courts have rejected these attempts, holding that federal courts lacked jurisdiction because the respondents had failed to raise and exhaust the argument in the administrative proceedings. *See, e.g.*, *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016); *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016); *Jarkesy v. SEC*, 803 F.3d 9 (D.C. Cir. 2015); *Bebo v. SEC*, 799 F.3d 765 (7th Cir. 2015). Here, Mr. Bandimere did not file a collateral lawsuit.

II. DISCUSSION

The SEC rejected Mr. Bandimere's argument that the ALJ presided over his hearing in violation of the Appointments Clause. We review the agency's conclusion on this constitutional issue de novo. *Hill v. Nat'l Transp. Safety Bd.*, 886 F.2d 1275, 1278 (10th Cir. 1989). We first explain why we must address Mr. Bandimere's constitutional argument and then address its merits.

A. *Constitutional Avoidance*

Federal courts avoid unnecessary adjudication of constitutional issues. *City of Mesquite v. Aladdin's Castle, Inc.*, 455 U.S. 283, 294 (1982). Here, we must consider the Appointments Clause issue.

In its opinion, the SEC concluded Mr. Bandimere committed two securities fraud violations and two securities registration violations.[3] In his petition for review, Mr. Bandimere challenges the SEC's findings of securities fraud liability as arbitrary and capricious, but he does not challenge the registration violations on these nonconstitutional grounds. He attacks the SEC's opinion as a whole, however, including both his securi-

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He instead raised his constitutional argument before the SEC, which rejected it. We therefore have jurisdiction to address the Appointments Clause issue as properly presented in Mr. Bandimere's petition for review.

[3] Specifically, the SEC held him liable for (1) securities fraud under Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities and Exchange Act of 1934 ("Exchange Act"), and 17 C.F.R. § 240.10b-5; (2) failure to register as a broker before selling securities under Exchange Act Section 15(a); and (3) failure to register the securities he was selling under Securities Act Sections 5(a) and (c). SEC Release No. 9972, 2015 WL 6575665, at *2, *4, *7, *17.

ties fraud and registration liability, based on the Appointments Clause.[4] Because the sole argument attacking his registration liability is constitutional, we cannot avoid the Appointments Clause question. And because resolving this question relieves Mr. Bandimere of all liability, we need not address his remaining arguments on securities fraud liability.

B. *Appointments Clause Overview*

The Appointments Clause states:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

U.S. Const. art. II, § 2, cl. 2.

The Appointments Clause embodies both separation of powers and checks and balances. *Ryder v. United States*, 515 U.S. 177, 182 (1995) ("The Clause is a bulwark against one branch aggrandizing its power at the expense of another branch . . . .").[5] By defin-

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[4] Mr. Bandimere's petition states, "The [SEC's] Opinion must be vacated because it resulted from a process in which an improperly appointed inferior officer played an integral role." Aplt. Br. at 18; *see also id.* at 10, 13.

[5] James Madison argued in Federalist Nos. 48 and 51 that checks and balances are needed to sustain a workable separation of powers. The Federalist Nos. 48 and 51, at 308, 318-19 (James Madi-

ing unique roles for each branch in appointing officers, the Clause separates power. It also checks and balances the appointment authority of each branch by providing (1) the President may appoint principal officers only with Senate approval and (2) Congress may confer appointment power over inferior officers to the President, courts, or department heads but may not itself make appointments.[6]

The Appointments Clause also promotes public accountability by identifying the public officials who appoint officers. *Edmond v. United States*, 520 U.S. 651, 660 (1997). And it prevents the diffusion of that power by restricting it to specific public officials. *Ryder*, 515 U.S. at 182; *Freytag*, 501 U.S. at 878, 883. "The Framers understood . . . that by limiting the appointment power, they could ensure that those who

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son) (Clinton Rossiter ed., 1961); *see also* M.J.C. Vile, Constitutionalism and the Separation of Powers 153, 159-60 (1967).

[6] In Federalist No. 76, Alexander Hamilton explained the Senate-approval requirement "would be an excellent check upon a spirit of favoritism in the President, and would tend greatly to prevent the appointment of unfit characters from State prejudice, from family connection, from personal attachment, or from a view to popularity." The Federalist No. 76, at 456 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

In *Weiss v. United States*, 510 U.S. 163 (1994), the Supreme Court stated the Framers structured "an alternative appointment method for inferior officers" to promote "accountability and check governmental power: any decision to dispense with Presidential appointment and Senate confirmation is Congress's to make, not the President's, but Congress's authority is limited to assigning the appointing power to the highly accountable President or the heads of federal departments, or, where appropriate, to the courts of law." 510 U.S. at 187.

wielded it were accountable to political force and the will of the people." *Freytag*, 501 U.S. at 884.

C. *Inferior Officers and* Freytag

1. Inferior Officers and the Supreme Court

The Supreme Court has defined an officer generally as "any appointee exercising significant authority pursuant to the laws of the United States." *Buckley v. Valeo*, 424 U.S. 1, 126 (1976) (per curiam). The term "inferior officer" "connotes a relationship with some higher ranking officer or officers below the President: Whether one is an 'inferior' officer depends on whether he has a superior." *Edmond*, 520 U.S. at 662.[7]

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[7] Other uses of "inferior" in the Constitution confirm the term speaks to a hierarchical, subordinate-superior relationship. The word appears once in Article I and twice in Article III, each time describing courts "inferior" to the Supreme Court. U.S. Const. art. I, § 8, cl. 9; *id.* art. III, § 1; *see also* Akhil Reed Amar, *Intratextualism*, 112 Harv. L. Rev. 747, 805-07 (1999) (discussing the use of "inferior" in Articles I, II, and III).

Statements from Alexander Hamilton and James Madison also indicate "inferior" means subordinate. In Federalist No. 81, Hamilton described inferior courts as those "subordinate to the Supreme." The Federalist No. 81, at 484 (Alexander Hamilton) (Clinton Rossiter ed., 1961). In the brief debate about the Excepting Clause at the Federal Constitutional Convention in 1787, Madison "mention[ed] (as in apparent contrast to the 'inferior officers' covered by the provision) 'Superior Officers.'" *Morrison v. Olson*, 487 U.S. 654, 720 (1988) (Scalia, J., dissenting) (citing 2 The Records of the Federal Convention of 1787 627-28 (M. Farrand ed., rev. ed. 1966)). He also referred to "subordinate officers" in contradistinction to "principal officers" when explaining the appointment power during the Virginia ratification convention. 3 The Debates in the Several State Conventions on the Adoption of the Federal Constitution 409-10 (Jonathan Elliot ed., 2d ed. 1836); *see*

This description of "inferior" may aid in understanding the distinction between principal and inferior officers. But we are concerned here with the distinction between inferior officers and employees. Like inferior officers, employees—or "lesser functionaries"—are subordinates. *Buckley*, 424 U.S. at 126 n.162.

Justice Breyer has provided this summary of the different ways the Supreme Court has described inferior officers:

> Consider the [Supreme] Court's definitions: Inferior officers are, *inter alia*, (1) those charged with "the administration and enforcement of the public law," *Buckley*, 424 U.S. at 139; (2) those granted "significant authority," *id.* at 126; (3) those with "responsibility for conducting civil litigation in the courts of the United States," *id.* at 140; and (4) those "who can be said to hold an office," *United States v. Germaine*, 99 U.S. 508, 510 (1879), that has been created either by "regulations" or by "statute," *United States v. Mouat*, 124 U.S. 303, 307-08 (1888).

Free Enter. Fund v. PCAOB, 561 U.S. 477, 539 (2010) (Breyer, J., dissenting) (citation style altered and some citations omitted).

The list below contains examples of inferior officers drawn from Supreme Court cases spanning more than 150 years:

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

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also Tuan Samahon, *Are Bankruptcy Judges Unconstitutional? An Appointments Clause Challenge*, 60 Hastings L.J. 233, 251 (2008) (discussing Madison's remarks at the Virginia convention).

- an "assistant-surgeon," *United States v. Moore*, 95 U.S. 760, 762 (1877);
- "thousands of clerks in the Departments of the Treasury, Interior, and the othe[r]" departments, *Germaine*, 99 U.S. at 511 (1878)
- an election supervisor, *Ex parte Siebold*, 100 U.S. 371, 397-98 (1879);
- a federal marshal, *id.* at 397;
- a "cadet engineer" appointed by the Secretary of the Navy, *United States v. Perkins*, 116 U.S. 483, 484-85 (1886);
- a "commissioner of the circuit court," *United States v. Allred*, 155 U.S. 591, 594-96 (1895);
- a vice consul temporarily exercising the duties of a consul, *United States v. Eaton*, 169 U.S. 331, 343 (1898);
- extradition commissioners, *Rice v. Ames*, 180 U.S. 371, 378 (1901);
- a United States commissioner in district court proceedings, *Go-Bart Importing Co. v. United States*, 282 U.S. 344, 352-54 (1931);
- a postmaster first class, *Buckley*, 424 U.S. at 126 (1976) (citing *Myers v. United States*, 272 U.S. 52 (1926));
- Federal Election Commission ("FEC") commissioners, *id.*;
- an independent counsel, *Morrison v. Olson*, 487 U.S. 654, 671 (1988);

- Tax Court special trial judges, *Freytag*, 501 U.S. at 881-82 (1991); and
- military judges, *Weiss v. United States*, 510 U.S. 163, 170 (1994); *Edmond*, 520 U.S. at 666 (1997).[8]

We think these examples are relevant and instructive. Although the Supreme Court has not stated a specific test for inferior officer status, "[e]fforts to define ['inferior Officers'] inevitably conclude that the term's sweep is unusually broad," *Free Enter. Fund*, 561 U.S. at 539 (Breyer, J., dissenting), and the *Freytag* opinion provides the guidance needed to decide this appeal.

2. ***Freytag***

The question in *Freytag* was whether the Tax Court had authority to appoint special trial judges ("STJs") under the Appointments Clause. 501 U.S. at 877-92. As a threshold matter, the Court addressed whether STJs were inferior officers or employees. *Id.* at 880-82. That question strongly resembles the one we face here. In our view, *Freytag* controls the result of this case.

Under the then-applicable 26 U.S.C. § 7443A(b), the Tax Court could assign four categories of cases to STJs. *Id.* at 873. For the first three categories, § 7443A(b)(1), (2), and (3), "the Chief Judge [could] assign the special trial judge not only to hear and report on a case but also to decide it." *Id.* In other words, STJs could make final decisions in those cases. But in the fourth category, § 7443A(b)(4), STJs lacked final decision-

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[8] *See also Edmond*, 520 U.S. at 661 (listing examples of inferior officers); *Free Enter. Fund*, 561 U.S. at 540 (Breyer, J., dissenting) (listing examples of officers).

making power: "the chief judge [could] authorize the special trial judge only to hear the case and prepare proposed findings and an opinion. The actual decision then [was] rendered by a regular judge of the Tax Court." *Id.*

The Tax Court assigned the petitioners' case to the STJ under § 7443A(b)(4), the fourth category, which did not allow STJs to enter final decisions. *Id.* at 871-73. The STJ issued a proposed opinion concluding the petitioners were liable, and the Tax Court adopted it. *Id.* at 871-72.[9] On appeal, the petitioners argued the STJs were inferior officers under the Appointments Clause and that the chief judge of the Tax Court could not appoint them because he was not the President, a court of law, or a department head. *Id.* at 878. The government contended STJs were not inferior officers because they did not have authority to enter a final decision in petitioners' case. *Id.* at 881.

The Court first expressly approved prior decisions from the Tax Court and the Second Circuit that held STJs were inferior officers. *Id.* "Both courts considered the degree of authority exercised by the special trial judges to be so 'significant' that it was inconsistent with the classifications of 'lesser functionaries' or employees." *Id.* (discussing *Samuels, Kramer & Co. v. Comm'r of Internal Revenue*, 930 F.2d 975 (2d Cir.

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[9] As discussed below, Ballard v. Commissioner of Internal Revenue, 544 U.S. 40 (2005), spelled out the STJs' and Tax Court judges' collaborative decision-making process in which STJs and Tax Court judges jointly "worked over" STJs' preliminary "in-house drafts" to produce an opinion. 544 U.S. at 42.

1991); *First W. Gov't Sec., Inc. v. Comm'r of Internal Revenue*, 94 T.C. 549 (1990)).[10]

The Court then turned to the government's argument that the STJs were employees because they "lack[ed] authority to enter a final decision" under § 7443A(b)(4). *Id.* The Court said the argument "ignore[d] the significance of the duties and discretion that special trial judges possess." *Id.* First, the STJ position was "established by Law." *Id.* (quoting U.S. Const. art. II, § 2, cl. 2). Second, "the duties, salary, and means of appointment for that office are specified by statute." *Id.*

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[10] In Samuels, the Second Circuit concluded STJs are inferior officers. 930 F.2d at 985. It stated:

> Although the ultimate decisional authority in cases under section 7443A(b)(4) rests with the Tax Court judges, the special trial judges do exercise a great deal of authority in such cases. The special trial judges are more than mere aids to the judges of the Tax Court. They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. Contrary to the contentions of the Commissioner, the degree of authority exercised by special trial judges is "significant." They exercise a great deal of discretion and perform important functions, characteristics that we find to be inconsistent with the classifications of "lesser functionary" or mere employee.

Id. at 985-86 (quoting *Buckley*, 424 U.S. at 126).

In First Western, the Tax Court concluded STJs are inferior officers: "Because [they] may be assigned any case and may enter decisions in certain cases, it follows that special trial judges exercise significant authority." 94 T.C. at 557.

Although a factor, final decision-making power was not the linchpin of the Tax Court's analysis. *Id.* And in any event, the *Freytag* Court endorsed the Second Circuit's and Tax Court's analyses because they relied on "the degree of authority" STJs possessed. *Freytag*, 501 U.S. at 881.

"These characteristics," the Court stated, "distinguish special trial judges from special masters, who are hired by Article III courts on a temporary, episodic basis, whose positions are not established by law, and whose duties and functions are not delineated in a statute." *Id.* Third, STJs "perform more than ministerial tasks. They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. In the course of carrying out these important functions, the [STJs] exercise significant discretion." *Id.* at 881-82. Accordingly, the Court held STJs were inferior officers. *Id.*

Next, the Court addressed a standing argument from the government. *Id.* at 882. The government had conceded STJs act as inferior officers when hearing cases under § 7443A(b)(1), (2), and (3), but argued petitioners "lack[ed] standing to assert the rights of taxpayers whose cases [were] assigned to [STJs] under [those three categories]." *Id.*

The Court stated, "*Even if* the duties of [STJs] under [§ 7443A(b)(4)] were not as significant as we and the two courts have found them to be, our conclusion would be unchanged." *Id.* (emphasis added). The Court explained that an inferior officer does not become an employee because he or she "on occasion performs duties that may be performed by an employee not subject to the Appointments Clause." *Id.* "If a special trial judge is an inferior officer for purposes of subsections (b)(1), (2), and (3), he is an inferior officer within the meaning of the Appointments Clause and he must be properly appointed." *Id.* The Court thus rejected the government's standing argument as "beside the point." *Id.*

In the end, the *Freytag* majority held the Tax Court was a "Cour[t] of Law" with authority to appoint inferior officers like the STJs. *Id.* at 890, 892. Justice Scalia's partial concurrence, joined by three other justices, agreed with the majority's conclusion regarding the STJs' status: "I agree with the Court that a special trial judge is an 'inferior Office[r]' within the meaning of [the Appointments Clause]." *Id.* at 901 (Scalia, J., concurring) (first alteration in original). Thus, a unanimous Supreme Court concluded STJs were inferior officers.

D. ***SEC ALJs***

The SEC conceded in its opinion that its ALJs are not appointed by the President, a court of law, or the head of a department. SEC Release No. 9972, 2015 WL 6575665, at *19. The sole question is whether SEC ALJs are inferior officers under the Appointments Clause. Under *Freytag*, we must consider the creation and duties of SEC ALJs to determine whether they are inferior officers. 501 U.S. at 881-82.

The APA created the ALJ position. 5 U.S.C. § 556(b)(3); *see also Mullen v. Bowen*, 800 F.2d 535, 540 n.5 (6th Cir. 1986) ("[T]he ALJ's position is not a creature of administrative law; rather, it is a direct creation of Congress under the [APA]."). Section 556 of the APA describes the duties of the "presiding employe[e]" at an administrative adjudication. 5 U.S.C. § 556. It states, "There shall preside at the taking of evidence . . . (1) the agency; (2) one or more members of the body which comprises the agency; or (3) one or more administrative law judges appointed under section 3105 of this title." *Id.* § 556(b).

Under 5 U.S.C. § 3105, "Each agency shall appoint as many administrative law judges as are necessary for proceedings required to be conducted in accordance with [5 U.S.C. §§ 556, 557]." Agencies hire ALJs through a merit-selection process administered by the Office of Personnel Management ("OPM"), which places ALJs within the civil service (i.e., the "competitive service"). 5 U.S.C. § 1302; 5 C.F.R. § 930.201. ALJ applicants must be licensed attorneys with at least seven years of litigation experience. 5 C.F.R. § 930.204; Office of Pers. Mgmt., Qualification Standard for Administrative Law Judge Positions, https://perma.cc/2G7J-X5BW. OPM administers an exam and uses the results to rank applicants. 5 C.F.R. § 337.101. Agencies may select an ALJ from the top three ranked candidates.[11] The SEC's Chief ALJ hires from the top three candidates subject to "approval and processing by the [SEC's] Office of Human Resources." Notice of Filing at 2, Timbervest, LLC, File No. 3-15519, https://perma.cc/G8M2-36P3 (SEC Division of Enforcement filing in administrative enforcement action). Once hired, ALJs receive career appointments, 5 C.F.R. § 930.204(a), and are removable only for good cause, 5 U.S.C. § 7521. Their pay is detailed in 5 U.S.C. § 5372. The SEC currently employs five ALJs. Office of Pers. Mgmt., ALJs by Agency, https://perma.cc/6RYA-VQFV.

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[11] *See* Vanessa K. Burrows, Cong. Res. Serv., Administrative Law Judges: An Overview at 2 (2010), https://perma.cc/T8YY-EE7F; Robin J. Arzt et al., Fed. Admin. Law Judge Found., Advancing the Judicial Independence and Efficiency of the Administrative Judiciary: A Report to the President-Elect of the United States, 29 J. Nat'l Ass'n Admin. L. Judiciary 93, 101 (2009).

The SEC has authority to delegate "any of its functions" except rulemaking to its ALJs. 15 U.S.C. § 78d-1(a). And SEC regulations task ALJs with "conduct[ing] hearings" and make them "responsible for the fair and orderly conduct of the proceedings." 17 C.F.R. § 200.14. SEC ALJs "have the authority to do all things necessary and appropriate to discharge [their] duties." 17 C.F.R. § 201.111.[12] The table below lists examples of those duties.

Duty	Provision(s)
Administer oaths and affirmations	5 U.S.C. § 556(c)(1) 17 C.F.R. § 200.14(a)(1) 17 C.F.R. § 201.111(a)
Consolidate "proceedings involving a common question of law or fact"	17 C.F.R. § 201.201(a)
"Determin[e]" the "scope and form of evidence, rebuttal evidence, if any, and cross-examination, if any"	17 C.F.R. § 201.326
Enter default judgment	17 C.F.R. § 201.155
Examine witnesses	17 C.F.R. § 200.14(a)(4)
Grant extensions of time or stays	17 C.F.R. § 201.161
Hold prehearing conferences	17 C.F.R. § 200.14(a)(6)

[12] Many of the SEC regulations refer to the duties of the "hearing officer." Under 17 C.F.R. § 201.101(a)(5), a "hearing officer" includes an ALJ. This opinion applies only to SEC ALJs specifically and not to hearing officers generally.

Hold settlement conferences and require attendance of the parties	5 U.S.C. § 556(c)(6) 5 U.S.C. § 556(c)(8) 17 C.F.R. § 201.111(e)
Inform the parties about alternative means of dispute resolution	5 U.S.C. § 556(c)(7) 17 C.F.R. § 201.111(k)
Issue protective orders	17 C.F.R. § 201.322
Issue, revoke, quash, or modify subpoenas	5 U.S.C. § 556(c)(2) 17 C.F.R. § 200.14(a)(2) 17 C.F.R. § 201.111(b) 17 C.F.R. § 201.232(e)
Order and regulate depositions	17 C.F.R. § 201.233
Order and regulate document production	17 C.F.R. § 201.230
Prepare an initial decision containing factual findings and legal conclusions, along with an appropriate order	5 U.S.C. § 556(c)(10) 17 C.F.R. § 200.14(a)(8) 17 C.F.R. § 200.30-9(a) 17 C.F.R. § 201.111(i) 17 C.F.R. § 201.360
Punish contemptuous conduct by excluding a person from a deposition, hearing, or conference or by suspending a person from representing others in the proceeding	17 C.F.R. § 201.180(a)

Regulate the course of the hearing and the conduct of the parties and counsel	5 U.S.C. § 556(c)(5) 17 C.F.R. § 200.14(a)(5) 17 C.F.R. § 201.111(d)
Reject deficient filings, order a party to cure deficiencies, and enter default judgment for failure to cure deficiencies	17 C.F.R. § 201.180(b), (c)
Reopen any hearing prior to filing an initial decision or prior to the fixed time for the parties to file final briefs with the SEC	17 C.F.R. § 201.111(j)
Rule on all motions, including dispositive and procedural motions	5 U.S.C. § 556(c)(9) 17 C.F.R. § 200.14(a)(7) 17 C.F.R. § 201.111(h) 17 C.F.R. § 201.220 17 C.F.R. § 201.250
Rule on offers of proof and receive relevant evidence 5 U.S.C. § 556(c)(3)	17 C.F.R. § 200.14(a)(3) 17 C.F.R. § 201.111(c)
Set aside, make permanent, limit, or suspend temporary sanctions the SEC issues	17 C.F.R. § 200.30-9(b) 17 C.F.R. § 201.531
Take depositions or have depositions taken	5 U.S.C. § 556(c)(4)

E. *SEC ALJs Are Inferior Officers Under* Freytag

Following *Freytag*, we conclude SEC ALJs are inferior officers under the Appointments Clause. As the SEC acknowledges, the ALJ who presided over Mr. Bandimere's hearing was not appointed by the President, a court of law, or a department head. He there-

fore held his office in conflict with the Appointments Clause when he presided over Mr. Bandimere's hearing.

Freytag held that STJs were inferior officers based on three characteristics. Those three characteristics exist here: (1) the position of the SEC ALJ was "established by Law," *Freytag*, 501 U.S. at 881 (quoting U.S. Const. art. II, § 2, cl. 2); (2) "the duties, salary, and means of appointment . . . are specified by statute," *id.*; and (3) SEC ALJs "exercise significant discretion" in "carrying out . . . important functions," *id.* at 882.

First, the office of the SEC ALJ was established by law. The APA established the ALJ position. 5 U.S.C. § 556(b)(3). In addition, the Securities and Exchange Act of 1934 authorizes the SEC to delegate "any of its functions" with the exception of rulemaking to ALJs,[13]

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[13] The dissent's concern about how this opinion might affect the SEC ALJs' role in rulemaking is misplaced. Dissent at 14. SEC ALJs do not have a rulemaking role: the Exchange Act does not allow the SEC to delegate rulemaking authority to its ALJs. 15 U.S.C. § 78d-1(a) ("Nothing in this section shall be deemed . . . to authorize the delegation of the function of rule making . . . ."); *see also Raymond J. Lucia Cos., Inc. v. SEC*, 832 F.3d 277, 281 (D.C. Cir. 2016) (stating "the authority to delegate [does] not extend to the [SEC's] rulemaking authority"). Other agencies' ALJs rarely exercise rulemaking authority. *See, e.g.*, *Perez v. Mortg. Brokers Ass'n*, 135 S. Ct. 1199, 1222 n.5 (2015) (Thomas, J., concurring) ("Today, . . . formal rulemaking is the Yeti of administrative law. There are isolated sightings of it in the ratemaking context, but elsewhere it proves elusive."); Kent Barnett, *Resolving the ALJ Quandary*, 66 Vand. L. Rev. 797 (2013) ("[F]ormal rulemaking is extremely rare . . . ."). Nevertheless, to the extent the dissent is concerned with other ALJs' rulemaking authority, we do not address the issue because our sole question is whether SEC ALJs are inferior officers.

and 17 C.F.R. § 200.14, a regulation promulgated under the Act, gives the agency's "Office of Administrative Law Judges" power to "conduct hearings" and "proceedings." *See* 15 U.S.C. § 78d-1(a) (authorizing SEC to delegate functions to ALJs); 17 C.F.R. § 200.1 (stating statutory basis for SEC regulations).

Second, statutes set forth SEC ALJs' duties, salaries, and means of appointment. 5 U.S.C. §§ 556-57 (duties); *id.* § 5372(b) (salary); *id.* §§ 1302, 3105 (means of appointment).[14] SEC ALJs are not "hired . . . on a temporary, episodic basis." *Freytag*, 501 U.S. at 881. They receive career appointments and can be removed only for good cause. 5 U.S.C. § 7521; 5 C.F.R. § 930.204(a).

Third, SEC ALJs exercise significant discretion in performing "important functions" commensurate with the STJs' functions described in *Freytag*. SEC ALJs have "authority to do all things necessary and appropriate to discharge his or her duties."[15] This includes authority to shape the administrative record by taking testimony,[16] regulating document production and depositions,[17] ruling on the admissibility of evidence,[18] receiving evidence,[19] ruling on dispositive and procedur-

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[14] The SEC concedes that the way it appoints its ALJs does not comply with the Appointments Clause. SEC Release No. 9972, 2015 WL 6575665 at *19.

[15] 17 C.F.R. § 201.111.

[16] 5 U.S.C. § 556(b), (c)(4).

[17] 17 C.F.R. §§ 201.230, 201.233.

[18] *Id.* § 556(c)(3); 17 C.F.R. § 200.14(a)(3).

[19] 17 C.F.R. § 201.111(c).

al motions,[20] issuing subpoenas,[21] and presiding over trial-like hearings.[22] When presiding over trial-like hearings, SEC ALJs make credibility findings to which the SEC affords "considerable weight" during agency review.[23]

They also have authority to issue initial decisions that declare respondents liable and impose sanctions.[24] When a respondent does not timely seek agency review, "the action of [the ALJ] shall, for all purposes,

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[20] 5 U.S.C. § 556(c)(9); 17 C.F.R. §§ 200.14(a)(3), (7), 201.111(h), 201.220, 201.250.

[21] 5 U.S.C. § 556(c)(2); 17 C.F.R. §§ 200.14(a)(2), 201.111(b).

[22] 5 U.S.C. § 556(b); 17 C.F.R. § 200.14(a).

[23] SEC Release No. 9972, 2015 WL 6575665, at *15 n.83 (deferring to SEC ALJ's credibility findings in the face of conflicting testimony). The dissent argues STJs exercise "significant authority" because the Tax Court was "'required to defer' to the [STJs'] factual and credibility findings 'unless they were clearly erroneous,'" Dissent at 3 (quoting *Landry*, 204 F.3d at 1133). But SEC ALJs' credibility findings also receive deference. The SEC affords their credibility findings "considerable weight and deference," Thomas C. Bridge, SEC Release No. 9068, 2009 WL 3100582, at *18 n.75 (Sept. 29, 2009), and accepts the findings "absent substantial evidence to the contrary," Steven Altman, SEC Release No. 63306, 2010 WL 5092725, at *10 (Nov. 10, 2010). *See also* Robert Thomas Clawson, SEC Release No. 48143, 2003 WL 21539920, at *2 (July 9, 2003) (stating the SEC "accepts" the ALJs' credibility findings "absent overwhelming evidence to the contrary"). Both the Tax Court and the SEC defer to credibility findings but are not required to accept those findings if they are undermined by other evidence. Thus, SEC ALJs, like STJs, exercise significant authority in part because the SEC defers to their credibility findings.

[24] 5 U.S.C. § 556(c)(10); 17 C.F.R. §§ 200.14(a)(8), 200.30-9(a), 201.111(i), 201.360; *see also* SEC Release No. 507, 2013 WL 5553898.

including appeal or review thereof, be deemed the action of the Commission."[25] Even when a respondent timely seeks agency review, the agency may decline to review initial decisions adjudicating certain categories of cases.[26]

Further, SEC ALJs have power to enter default judgments[27] and otherwise steer the outcome of proceedings by holding and requiring attendance at settlement conferences.[28] They also have authority to set

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[25] 15 U.S.C. § 78d-1(c). The SEC and the dissent argue the SEC ALJs do not exercise significant authority when issuing initial decisions because the agency retains a right to review the decisions de novo. But this argument is incomplete. The agency has discretion to engage in de novo review, 15 U.S.C. § 78d-1(b), but also has discretion not to engage in de novo review before an initial decision becomes final, 17 C.F.R. § 201.360(d)(2) (stating the agency can make an initial decision final by entering an order). In fact, the agency has no duty, based on the regulation's plain language, to review an unchallenged initial decision before entering an order stating the decision is final. 17 C.F.R. § 201.360(d)(2). Thus, SEC ALJs exercise significant authority in part because their initial decisions can and do become final without plenary agency review. Indeed, 90 percent of those initial decisions become final without plenary review. SEC, ALJ Initial Decisions, https://www.sec.gov/alj/aljdec.shtml (archiving initial decisions); *see also* Amici Br. at 13-14.

Further, an SEC ALJ's authority to issue an initial decision is significant because, even if reviewed de novo, the ALJ plays a significant role as detailed above in conducting proceedings and developing the record leading to the decision, and the decision publicly states whether respondents have violated securities laws and imposes penalties for violations. *Id.* § 201.360(c) (requiring the agency to publish the initial decision on the SEC docket).

[26] 17 C.F.R. § 201.411(b)(2).

[27] 17 C.F.R. § 201.155.

[28] 5 U.S.C. § 556(c)(6), (8); 17 C.F.R. § 201.111(e).

aside, make permanent, limit, or suspend temporary sanctions that the SEC itself has imposed.[29]

In sum, SEC ALJs closely resemble the STJs described in *Freytag*. Both occupy offices established by law; both have duties, salaries, and means of appointment specified by statute; and both exercise significant discretion while performing "important functions" that are "more than ministerial tasks." *Freytag*, 501 U.S. at 881-82; *see also Samuels*, 930 F.2d at 986. Further, both perform similar adjudicative functions as set out above.[30] We therefore hold that the SEC ALJs

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[29] 17 C.F.R. §§ 200.30-9, 201.531; *see also* 15 U.S.C. § 78u-3(c) (describing temporary order); 17 C.F.R. § 201.101(a)(11) (stating a temporary sanction is "a temporary cease-and-desist order or a temporary suspension of . . . registration"); *id.* §§ 201.510(b), 201.512(a), 201.521(b), 201.522(a) (describing a temporary sanction and stating an SEC commissioner presides over the hearing and that the agency must issue the order); *id.* § 201.531(a)(1) (stating an initial decision "shall specify" which terms or conditions of a temporary sanction "shall become permanent"); *id.* § 201.531(a)(2) (stating an initial decision "shall specify" "whether a temporary suspension of a respondent's registration, if any, shall be made permanent"); *id.* § 201.531(b) (stating an order modifying a temporary sanction "*shall be effective* 14 days after service" (emphasis added)).

[30] The dissent complains that the majority opinion "lists the duties of SEC ALJs, without telling us which, if any, were more important to its decision than others and why." Dissent at 11. But this misses the point of our following *Freytag*. There, the Court identified four duties that supported the STJs' inferior officer status: "They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders." 501 U.S. at 881-82. We point out above that SEC ALJs perform comparable duties, and we spell out even more of their discretionary functions.

are inferior officers who must be appointed in conformity with the Appointments Clause.[31]

This holding serves the purposes of the Appointments Clause. The current ALJ hiring process whereby the OPM screens applicants, proposes three finalists to the SEC, and then leaves it to somebody at the agency to pick one, is a diffuse process that does not lend itself to the accountability that the Appointments Clause was written to secure. In other words, it is unclear where the appointment buck stops. The current hiring system would suffice under the Constitution if SEC ALJs were employees, but we hold under *Freytag* that they are inferior officers who must be appointed as the Constitution commands. As the Supreme Court said in *Freytag*, "The Appointments Clause prevents Con-

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[31] Those who challenge agency action typically have the burden to show prejudicial error. 5 U.S.C. § 706; *Shinseki v. Sanders*, 556 U.S. 396, 406-07 (2009). The error here is structural because the Supreme Court has recognized the separation of powers as a "structural safeguard." *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 239 (1995) (emphasis omitted). Structural errors are not subject to prejudicial-error review. *See Rivera v. Illinois*, 556 U.S. 148, 161 (2009) (stating "constitutional errors concerning the qualification of the jury or judge" require automatic reversal (emphasis omitted)); *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 123 (D.C. Cir. 2015) ("[A]n Appointments Clause violation is a structural error that warrants reversal regardless of whether prejudice can be shown."); *United States v. Solon*, 596 F.3d 1206, 1211 (10th Cir. 2010) (stating structural errors are subject to automatic reversal).

Mr. Bandimere argues, "[The SEC ALJ] is an inferior officer whose unconstitutional appointment is a structural constitutional error that invalidates the proceeding." Aplt. Br. at 18. The SEC does not dispute that an Appointments Clause error here is structural and that there is no need to show prejudice.

gress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint." 501 U.S. at 880.

F. *The SEC's Arguments*

1. Final Decision-Making Power

In rejecting Mr. Bandimere's Appointments Clause argument during agency review, the SEC's opinion concluded the ALJs are not inferior officers because they cannot render final decisions and the agency retains authority to review ALJs' decisions de novo.

The SEC makes similar arguments here. It contends the *Freytag* Court relied on the STJs' final decision-making power when it held they were inferior officers. The agency draws on *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000), in which the D.C. Circuit attempted to distinguish *Freytag* and held that FDIC ALJs were employees. 204 F.3d at 1134. In *Landry*, the D.C. Circuit stated *Freytag* "laid exceptional stress on the STJs' final decisionmaking power." *Id.* The court therefore considered dispositive the FDIC ALJs' inability to render final decisions. *Id.*

This past August, the D.C. Circuit addressed the same question we face here. *Raymond J. Lucia Cos., Inc. v. SEC*, 832 F.3d 277, 283 (D.C. Cir. 2016). The D.C. Circuit followed *Landry* and concluded that SEC ALJs are employees and not inferior officers. *Id.* at 283-89. The holding was based on the court's conclusion that SEC ALJs cannot render final decisions. *Id.* at 285 ("[T]he parties principally disagree about whether [SEC] ALJs issue final decisions of the [SEC]. Our analysis begins, and ends, there."). We disagree with the SEC's reading of *Freytag* and its argument that

final decision-making power is dispositive to the question at hand.

First, both the agency and *Landry* place undue weight on final decision-making authority. *Freytag* stated the government's argument that STJs should be deemed employees when they lacked the ability to enter final decisions "ignore[d] the significance of the duties and discretion that [STJs] possess." 501 U.S. at 881. The Supreme Court held STJs are inferior officers because their office was established by law; their duties, salaries and means of appointments were "specified by statute"; and they "exercise[d] significant discretion" in "carrying out . . . important functions." *Id.* at 881-82.

Moreover, *Freytag* agreed with the Second Circuit's *Samuels* decision, *id.*, which held that STJs are inferior officers because they "exercise a great deal of discretion and perform important functions" in § 7443A(b)(4) cases, *Samuels*, 930 F.2d at 986. The Second Circuit did not rely on the STJs' ability to enter final decisions under § 7443A(b)(1), (2), and (3). *Id.* at 985-86. Rather, it said STJs are inferior officers even though "the ultimate decisional authority in cases under section 7443A(b)(4) rests with the Tax Court judges." *Id.* at 985. Like *Freytag*, *Samuels* hinged on the STJs' duties and not on final decision-making power.

After stating its holding that STJs are inferior officers based on their duties, the *Freytag* Court responded to the government's standing argument. 501 U.S. at 882. The Court stated, "*Even if* the duties of special trial judges under subsection (b)(4) were not as significant as we and the two courts have found them to be, our conclusion would be unchanged." *Id.* (emphasis

added). This sentence reaffirms what the Court previously concluded: it "found" the duties of the STJs are sufficiently significant to make them inferior officers. *Id.* That conclusion did not depend on the STJs' authority to make final decisions.[32]

Further, the Court's "even if" argument was a response to (1) the government's concession that STJs are inferior officers in § 7443A(b)(1), (2), and (3) cases, where they had final decision-making authority,[33] and (2) the government's argument that the petitioners lacked standing to rely on the STJs' authority in those types of cases to establish the STJs' inferior officer

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[32] Judge Randolph rebutted the *Landry* majority by arguing the following:

> The [*Freytag*] Court introduced its alternative holding thus: "Even if the duties of special trial judges [just described] were not as significant as we and the two courts have found them to be, our *conclusion* would be unchanged." 501 U.S. at 882 (italics added). What "conclusion" did the Court have in mind? The conclusion it had reached in the preceding paragraphs—namely, that although special trial judges may not render final decisions, they are nevertheless inferior officers of the United States within the meaning of Article II, § 2, cl. 2. The same conclusion, the same holding, had also been rendered in [*Samuels*], a decision the Supreme Court cited and expressly approved. *See* 501 U.S. at 881. There the Second Circuit held that a special trial judge performing the same advisory function as the judge in *Freytag* was an inferior officer; the court of appeals did not mention the fact that in other types of cases, the judge could issue final judgments.

Landry, 204 F.3d at 1142 (Randolph, J., concurring).

[33] "The Commissioner concedes that in cases governed by subsections (b)(1), (2), and (3), special trial judges act as inferior officers who exercise independent authority." 501 U.S. at 882.

status in § 7443A(b)(4) cases.[34] Based on the government's concession, the Court stated STJs could not transform to employees by "perform[ing] duties that may be performed by an employee not subject to the Appointments Clause." *Id.* The Court thus rejected the standing argument as "beside the point." *Id.*

The Court's rejection of the government's standing argument is a far cry from holding that final decision-making authority is the predicate for inferior officer status. Indeed, the Court did not hold that STJs are inferior officers because they have final decision-making authority in § 7443A(b)(1), (2), and (3) cases. Rather, it accepted the government's concession that STJs are inferior officers in those cases for the purpose of responding to the standing argument. Thus, the Court's "even if" argument did not modify or supplant its holding that STJs were inferior officers based on the "significance of [their] duties and discretion." *Id.* at 881.

The SEC reads *Freytag* as elevating final decision-making authority to the crux of inferior officer status. But properly read, *Freytag* did not place "exceptional stress" on final decision-making power.[35] To the con-

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[34] "But the Commissioner urges that petitioners may not rely on the extensive power wielded by the [STJ] in declaratory judgment proceedings and limited-amount tax cases because petitioners lack standing to assert the rights of taxpayers whose cases are assigned to [STJs] under subsections (b)(1), (2), and (3)." *Id.*

[35] *Compare Freytag*, 501 U.S. at 881-82 (rejecting the government's argument that STJs were employees when they lacked final decision-making power), *with Landry*, 204 F.3d at 1134 (asserting *Freytag* "laid exceptional stress on the STJs' final decisionmaking power").

trary, it rebutted the government's argument that STJs were inferior officers when they lacked final decision-making power (i.e., § 7443A(b)(4) cases) because the argument "ignore[d] the significance of the duties and discretion that [STJs] possess." *Freytag*, 501 U.S. at 881.

Final decision-making power is relevant in determining whether a public servant exercises significant authority. But that does not mean *every* inferior officer *must* possess final decision-making power. *Freytag*'s holding undermines that contention. In short, the Court did not make final decision-making power the essence of inferior officer status. Nor do we.

Second, the SEC's argument finds no support in other Supreme Court decisions describing inferior officers. In *Edmond*, the Supreme Court considered final decisionmaking power as relevant to the difference between a principal and inferior officer, not the difference between an officer and an employee. 520 U.S. at 665. The Court held Coast Guard Court of Criminal Appeals judges were inferior officers instead of principal officers because they "ha[d] no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers, and hence they [were] inferior within the meaning of Article II." *Id.* In other words, the Court classified the judges as inferior officers even though they had no final decision-making power. *Id.*

In *Buckley*, the Court held FEC commissioners were inferior officers because they exercised "significant authority," including the "responsibility for conducting civil litigation in the courts of the United States for vindicating public rights." 424 U.S. at 125-26, 140.

The *Buckley* Court analyzed significant authority as a matter of degree without discussing final decision-making power. *Id.*; *see also Ass'n of Am. Railroads v. U.S. Dep't of Transp.*, 821 F.3d 19, 38 (D.C. Cir. 2016) (stating *Edmond* "clarified [that] the degree of an individual's authority is relevant in marking the line between officer and nonofficer, not between principal and inferior officer" (citing *Edmond*, 520 U.S. at 662)).

The Court has not equated significant authority with final decision-making power in *Buckley*, *Freytag*, *Edmond*, or elsewhere. Nor has it indicated that each of the officers it has deemed inferior possesses that power.[36] Further, Justice Breyer has stated that "efforts to define ['inferior Officer'] inevitably conclude that the term's sweep is unusually broad." *Free Enter. Fund*, 561 U.S. at 539 (Breyer, J., dissenting).

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[36] Whether SEC ALJs can enter final decisions is not dispositive to our holding because it was not dispositive to *Freytag*'s holding. Nevertheless, the SEC's argument that its ALJs can never enter final decisions is not airtight. Without a timely petition for review, SEC ALJ's actions are "deemed the action of the Commission." 15 U.S.C. § 78d-1(c). The agency retains authority to review initial decisions de novo and may determine the date on which an unchallenged initial decision is final. 15 U.S.C. § 78d-1(b); 17 C.F.R. § 201.360(d)(2); *Lucia*, 832 F.3d at 286-87. But the agency may simply enter an order stating an initial decision is final without engaging in any review. 17 C.F.R. § 201.360(d)(2). And the agency can also decline to review an initial decision even when there is a timely petition for review. 17 C.F.R. § 201.411(b)(2). Thus, the Exchange Act and the agency's regulations provide a path for an initial decision to become final without plenary agency review. In practice, most initial decisions follow that path—90 percent. *See* SEC, ALJ Initial Decisions, https://www.sec.gov/alj/aljdec.shtml.

Third, supervision by superior officers is not unique to employees. It is a common feature of inferior officers as well.[37] The military judges at issue in *Edmond* were inferior officers based on their inability to "render a final decision . . . unless permitted to do so by other Executive officers." 520 U.S. at 665. Thus, the fact that the SEC can reverse its ALJs does not mean they are employees rather than inferior officers.

2. Deference to Congress

The SEC further contends Congress intended its ALJs to be employees. It urges us to "accor[d] significant weight" to congressional intent in determining whether the ALJs are inferior officers. Aplee. Br. at 41.

The SEC overstates its arguments. In its brief, it has not cited statutory language expressly stating ALJs are employees for purposes of the Appointments Clause. Nor has it cited legislative history indicating Congress has specifically addressed the question whether ALJs are inferior officers. And to the extent the SEC seeks to infer congressional intent from congressional action, the evidence is mixed.

On the one hand, the SEC stresses that Congress was "deliberate" in constructing the statutory framework governing the hiring of ALJs and the powers ALJs have in relation to their agencies. Aplee. Br. at 27.

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[37] *Edmond*, 520 U.S. at 663 (stating an inferior officer is "directed and supervised at some level by others who were appointed by Presidential nomination with advice and consent of the Senate"); *Landry*, 204 F.3d at 1142 (Randolph, J., concurring) ("The fact that an ALJ cannot render a final decision and is subject to the ultimate supervision of the FDIC shows only that the ALJ shares the common characteristic of an 'inferior Officer.'").

This includes placing the position within the civil service and tasking the OPM to prescribe rules governing ALJ hiring. 5 U.S.C. §§ 1302, 3105, 3313; 5 C.F.R. § 930.201. The SEC argues this suggests congressional intent to classify ALJs as employees. But, on the other hand, and as detailed previously, Congress granted significant authority to SEC ALJs in the APA and the Exchange Act and has authorized the agency to delegate "any of its [non-rulemaking] functions" to ALJs. 5 U.S.C. §§ 556, 557; 15 U.S.C. § 78d-1(a).

When it has faced a case or controversy concerning separation of powers, the Supreme Court has determined whether the legislative or executive branches or both have violated the Constitution. *See, e.g.*, *Bowsher v. Synar*, 478 U.S. 714 (1986); *INS v. Chadha*, 462 U.S. 919 (1983); *Buckley*, 424 U.S. at 1; *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803). This has been so even when a congressional scheme was carefully devised and effective. *Bowsher*, 478 U.S. at 736.[38] However "carefully devised" the ALJ system may be generally and the SEC ALJ program particularly, *see Lucia*, 832 F.3d at 289, that should not excuse failure to comply with the Appointments Clause. As a circuit court, we must follow Supreme Court precedent. *Hutto v. Davis*, 454 U.S.

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[38] In *Bowsher*, the Court stated:

> No one can doubt that Congress and the President are confronted with fiscal and economic problems of unprecedented magnitude, but "the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution. Convenience and efficiency are not the primary objectives—or the hallmarks—of democratic government."

478 U.S. at 736 (ellipsis omitted) (quoting *Chadha*, 462 U.S. at 944).

370, 375 (1982) (per curiam) ("[A] precedent of [the Supreme] Court must be followed by the lower federal courts."). And as explained, *Freytag* governs our result here.

Moreover, the Supreme Court's treatment of the government's deference argument in *Freytag* is instructive here. The government contended the Supreme Court should "defer to the Executive Branch's decision that there has been no legislative encroachment on Presidential prerogatives under the Appointments Clause." 501 U.S. at 879. The Court rejected that argument: "[T]he Clause forbids Congress to grant the appointment power to inappropriate members of the Executive Branch. Neither Congress nor the Executive can agree to waive this structural protection. . . . The structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic." *Id.* at 880; *see also NLRB v. Noel Canning*, 134 S. Ct. 2550, 2594 (2014) (Scalia, J., concurring in the judgment) ("[T]he political branches cannot by agreement alter the constitutional structure."). As stated, we question whether Congress has clearly classified SEC ALJs as employees. But even if it had, we would still follow *Freytag*.

G. ***The Dissent's Arguments***

We address three of the dissent's main arguments. First, it points out the STJs had "power to bind the Government and third parties," and the "SEC ALJs do not." Dissent at 1. This is the final authority argument the SEC makes here and that the D.C. Circuit relied on in *Landry* and *Lucia*. We have addressed this argument above.

Second, the dissent contends that "even where [STJs] could not enter final decisions, their initial decisions had binding effect." *Id.* at 2. The SEC did not make this argument. In any event, the contention is incorrect because it rests on a misapprehension of the Tax Court judges' and STJs' roles in cases where the Tax Court judges must make the final decisions, such as *Freytag*. *See Ballard v. Comm'r of Internal Revenue*, 544 U.S. 40, 44 (2005) (citing 26 U.S.C. § 7443A(c)) (stating Tax Court judges must make the "[u]ltimate decision in cases involving tax deficiencies that exceed $50,000"). The dissent asserts that the STJs in effect made the final decisions in those cases because the Tax Court "purported to adopt its [STJs'] opinions verbatim in 880 out of 880 cases between 1983 and 2005." Dissent at 8. At first blush, that assertion suggests the Tax Court rubber stamped 880 STJ recommendations without making a single change. But a full reading of the dissent's cited sources shows that assertion is incorrect.

In *Ballard*, a case the dissent mistakenly relies on to attempt to differentiate STJs and SEC ALJs,[39] the Supreme Court described the Tax Court's process of reviewing STJ's recommendations based on the government's own explanation of how Tax Court judges and STJs worked together. 544 U.S. at 58, 65 (stating the government "describe[d] and defend[ed]" its pro-

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[39] The dissent relies on *Ballard*, Dissent at 2-4, yet objects to our use of the case to rebut its argument that the Tax Court deferred to STJs on questions of law. *Id.* at 5 n.1. We do not rely on *Ballard* in reaching our holding or in responding to the SEC's arguments (because the SEC did not rely on it). We discuss the case only to respond to the dissent.

cess). Beginning in 1983, STJs submitted "reports" to the Tax Court judges tasked with making the final decision in each particular case. *Id.* at 58. In each case, the Tax Court judge treated the report as an "in-house draft" and engaged in a "collaborative process" with the STJ in which they "worked over" the report and produced an "opinion of the [STJ]." *Id.* at 57. "When the collaborative process [was] complete, the Tax Court judge issue[d] a decision in all cases agreeing with and adopting the opinion of the [STJ]." *Id.* (alterations and quotations omitted). In sum, the Tax Court judges adopted opinions they had a hand in supervising and producing.

The law review article the dissent cites explains why it is simply not true that the Tax Court rubber stamped 880 of 880 STJ opinions: "the Tax Court judge treated the report and recommendation of the [STJ] as a draft of an opinion that would, after a collaborative effort with the Tax Court judge, ultimately be adopted by the Tax Court." Christopher M. Pietruszkiewicz, *Conflating Standards of Review in the Tax Court: A Lesson in Ambiguity*, 44 Hous. L. Rev. 1337, 1360 (2008). The dissent's conclusion that the STJs' "initial report often decided the case," Dissent at 3, overstates the STJs' role. And their actual role hardly supports the notions that Tax Court judges "appeared to defer to its [STJs] on conclusions of law" or "that [the STJs] had as much authority as Tax Court judges themselves." *Id.* at 3, 6.[40] Even if the Tax Court did not review STJs'

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[40] The dissent states the Tax Court judge in *Freytag* adopted the STJ's report "verbatim." Dissent at 5 n.1. There is no indication that is true. By the time of the *Freytag* trial in 1987, the Tax Court had been practicing the "collaborative process" described

recommendations in most cases, that would not distinguish STJs from SEC ALJs. Most of the SEC ALJs' initial decisions—about 90 percent—become final without any review or revision from an SEC Commissioner.[41]

The dissent is left with its argument that in certain cases the STJs "had the power to bind third parties and the government itself." *Id.* at 6 n.2. But, as previously explained, *Freytag* did not regard this ground as dispositive to hold the STJs are inferior officers.[42]

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above for four years. *See Ballard*, 544 U.S. at 57 (stating the Tax Court began the "collaborative process" in 1983). The Tax Court judge in *Freytag* received the STJ's "*report*" and within four months adopted the STJ's "*opinion*," *Freytag*, 501 U.S. at 872 n.2 (emphasis added), which, as we learn from *Ballard*, is the document produced by the STJ *and* the Tax Court judge collaboratively, *Ballard*, 544 U.S. at 58.

In other words, *Freytag* appears to be an example of the collaborative process at work—the STJ provided the Tax Court judge a "report," and the Tax Court judge later adopted the STJ's "opinion" that resulted from the joint efforts of the STJ and Tax Court judge. Nevertheless, the dissent infers the Tax Court judge adopted the STJ's recommendation "verbatim," Dissent at 5 n.1, even though the Supreme Court declined "to assume 'rubber stamp' activity on the part of the [Tax Court judge]," *Freytag*, 501 U.S. at 872 n.2.

[41] Amici report and the agency does not dispute that approximately 90 percent of SEC ALJs' initial decisions issued in 2014 and 2015 became final without agency plenary review. Amici Br. at 13-14. Our review of the SEC's archives confirms this information. *See* SEC, ALJ Initial Decisions, https://www.sec.gov/alj/aljdec.shtml.

[42] The dissent does not state it disagrees with our reading of *Freytag*. Rather, it relies on passages from the petitioners' brief in *Freytag* to describe the characteristics of the STJs. What really counts, however, are the STJs' features the Supreme Court relied

Moreover, even if the STJs exercise more authority than the SEC ALJs, it does not follow that the former are inferior officers and the latter are employees or that the latter do not exercise significant authority. We agree that ALJs are not identical to STJs. But, as explained in detail above, STJs and ALJs closely resemble one another where it counts. SEC ALJs can still be inferior officers without possessing identical powers as STJs, just like STJs can still be inferior officers without possessing identical powers as FEC commissioners and assistant surgeons. *See Buckley*, 424 U.S. at 125-26; *Moore*, 95 U.S. at 762.[43]

Third, the dissent expresses concerns about "the probable consequences of today's decision." Dissent at 11. It goes on to raise issues that are not before us and that the parties did not brief.

We recognize that our holding potentially implicates other questions. But no other issues have been presented to us here, and we therefore cannot address them. Nothing in this opinion should be read to answer any but the precise question before this court: whether SEC ALJs are employees or inferior officers. Questions about officer removal, officer status of other agencies' ALJs, civil service protection, rulemaking,

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on to determine they are inferior officers. The *Freytag* opinion—not one side's advocacy brief—is the proper source for analysis. And, as our analysis shows, *Freytag* leads us to conclude the SEC ALJs are inferior officers.

[43] The dissent does not explain or even acknowledge the differences between inferior and principal officers. Nor does it recognize that inferior officers are subordinates who are still considered officers even when a superior officer directs their actions or makes final decisions.

and retroactivity, *see* Dissent at 11-15, are not issues on appeal and have not been briefed by the parties. Having answered the question before us, and thus resolved Mr. Bandimere's petition, we must leave for another day any other putative consequences of that conclusion.

III. CONCLUSION

SEC ALJs "are more than mere aids" to the agency. *Samuels*, 930 F.2d at 986. They "perform more than ministerial tasks." *Freytag*, 501 U.S. at 881. The governing statutes and regulations give them duties comparable to the STJs' duties described in *Freytag*. SEC ALJs carry out "important functions," *id.* at 882, and "exercis[e] significant authority pursuant to the laws of the United States," *Buckley*, 424 U.S. at 126. The SEC's power to review its ALJs does not transform them into lesser functionaries. Rather, it shows the ALJs are inferior officers subordinate to the SEC commissioners. *Edmond*, 520 U.S. at 663.

The SEC ALJ held his office unconstitutionally when he presided over Mr. Bandimere's hearing. We grant the petition for review and set aside the SEC's opinion.

No. 15-9586, Bandimere v. SEC

BRISCOE, Circuit Judge, concurring.

I write not to differ with the rationale of the majority opinion, but rather to fully join it. My focus here is on the dissent. I group my concerns in two categories: (I) the dissent's predictions about speculative "repercussions" of the opinion, by which it reaches what appear to be several erroneous conclusions; and (II) its application of a truncated legal framework to a misstated version of the facts of record.

I

Underlying the dissent's position is a concern about the next case, and the one after that. The dissent suggests that a "probable consequence[]" of the opinion is that "all" 1,792 "federal ALJs are at risk of being declared inferior Officers." Dissent at 11 & n.5. But this was no less true when Freytag v. Commissioner of Internal Revenue was decided. 501 U.S. 868 (1991). A "risk" always exists that a court will be called on to decide whether *any* particular federal employee or group of employees has been delegated sufficient authority to fall within the ambit of the Appointments Clause, U.S. Const. art. II, § 2, cl. 2, the Constitution's structural safeguard tethering key personnel—Officers—to the sovereign power of the United States, and thus to the people. Answering that question in the affirmative as to the SEC's five ALJs does no "mischief" to bedrock principles of constitutional law. Dissent at 16.

Further, the majority has not affected "thousands of administrative actions," id. at 11, by answering that question. Freytag instead commands that courts engage in a case-by-case analysis. 501 U.S. at 880-82.

Specifically, a court must determine whether a federal employee (or class of employees) is subject to the Appointments Clause by answering whether the employee exercises "significant authority pursuant to the laws of the United States," and, in turn, by analyzing the aggregate "duties and functions" the employee performs or is authorized to perform. Id. at 881 (quotation marks and citations omitted). That power sometimes comes in the form of final decision-making authority, id. at 882; other times, not. Id. at 881-82. The majority merely and correctly applies Freytag's test to answer that question as to the SEC's five ALJs.

Relatedly, the dissent errs when it suggests that the majority is operating without "much precedent." Dissent at 16. The majority simply applies Freytag's framework, as all lower courts must do. In truth, the dissent takes issue with and devotes much of its analysis to suggesting that the majority ought to follow the D.C. Circuit's *misapplication* of Freytag wrought in Landry v. FDIC, 204 F.3d 1125 (D.C. Cir. 2000), and bolstered by Raymond J. Lucia Cos., Inc. v. Securities and Exchange Commission, 832 F.3d 277 (D.C. Cir. 2016). The critical difference between the majority and Landry and Lucia is that the majority recognizes that Freytag does *not* make final decision-making authority the *sine qua non* of inferior Officer status. 501 U.S. at 881-82.

The D.C. Circuit erroneously suggested as much in Landry when it said, over Judge Randolph's contrary view, that the Freytag Court saw final decision-making authority as "exceptional[ly]" important and "critical" to determining Officer status. 204 F.3d at 1134. And Lucia compounded that error when it acknowledged

that the parties identified (as here) other powers the SEC's ALJs exercise but then narrowed its analysis to and rested its holding entirely on whether those ALJs can issue final decisions for the SEC. See 832 F.3d at 285 (acknowledging that "the parties principally," not only, "disagree[d] about whether" the SEC's "ALJs issue final decisions of the" SEC and explaining that the court's "analysis begins, and ends," with that question); id. at 285-89 (analyzing only whether the SEC's ALJs can render final decisions). The majority applies precedent: Freytag, not Landry or Lucia.

The dissent also contends that the majority's opinion "will be used to strip all ALJs of their dual layer for-cause protection." Dissent at 14. This troubling statement calls for a response because the dissent essentially predetermines the holdings of hypothetical cases not before this court.

In some future case, a litigant may argue that all ALJs are inferior Officers. But as the majority here explains—and Freytag commands—whether a particular federal employee or class of employees are Officers subject to the Appointments Clause requires a position-by-position analysis of the authority Congress by law and a particular executive agency by rule and practice has delegated to its personnel. 501 U.S. at 881-82. Some ALJs within particular agencies may exercise so little authority and also be subject to such complete oversight (e.g., unlike here, de novo review) that they are not Officers. The majority rightly does not attempt to answer whether each ALJ in every federal agency is an Officer because Freytag disclaims such sweeping pronouncements, id., and, in any event,

it is not necessary to do so to resolve Mr. Bandimere's appeal.

The dissent also does not stop after incorrectly stating that the majority has addressed an issue not before us. It instead goes on to suggest that the majority's nonanswer to an unasked question may lead to the implosion of the federal civil service, at least as to all federal ALJs. But the dissent is wrong as to the outcome of such a hypothetical future case. And in suggesting that this outcome follows from the majority's opinion, the dissent unnecessarily sounds alarms which demand rejoinder.

Specifically, the dissent worries that the consequence of the majority's opinion is that all federal ALJs are inferior Officers, that all federal ALJs are thus afforded the double-for-good-cause-removal protection forbidden by Free Enterprise Fund v. PCAOB, 561 U.S. 477 (2010), and that, as a result, all federal ALJs will lose their civil service protections. Warning of the dangers of such a conclusion, the dissent suggests that the Social Security Administration will be impaired when its 1,537 ALJs lose their civil service protections. But there are at least two errors in the dissent's speculation about facts not before this court.

First, it may well be that within the Social Security Administration ALJs are removable in a manner that does not run afoul of Free Enterprise Fund. For example, if the person or persons responsible for firing those ALJs are not afforded good-cause removal protections, then the Administration's ALJs will retain their civil service protections even if they are inferior Officers. The dissent cannot say for certain whether

this is so, because we have no briefing on the subject in this case, which deals only with the SEC.

Second, even assuming that *all* federal ALJs are Officers who are removable only for good cause and that they are *all* selected by Officers who are also removable only for good cause, the dissent knocks down a straw man by suggesting that Free Enterprise Fund might require stripping all ALJs of their civil service protections. Rather, as Free Enterprise Fund reminds us, courts normally are required to afford the *minimum* relief necessary to bring administrative overreach in line with the Constitution:

> Generally speaking, when confronting a constitutional flaw in a statute, we try to limit the solution to the problem, severing any problematic portions while leaving the remainder intact. Because the unconstitutionality of a part of an Act does not necessarily defeat or affect the validity of its remaining provisions, the normal rule is that partial, rather than facial, invalidation is the required course. . . . Concluding that the removal restrictions are invalid leaves [an Officer] removable . . . at will, and leaves the President separated from [the Officer] by only a single level of good-cause tenure.

Id. at 508-09 (quotation marks, alterations, and citations omitted).

The D.C. Circuit just recently employed this principle in PHH Corp. v. Consumer Financial Protection Bureau, 839 F.3d 1 (D.C. Cir. 2016). There, the court held, *inter alia*, that the Consumer Financial Protection Bureau (CFPB) was so structured as to violate Article II because it was headed by a single director

who was removable only for good cause. Id. at 12-39. But the remedy for this unconstitutional structure was not—as the petitioners had urged—the abrogation of the CFPB. Id. at 37. Applying Free Enterprise Fund and other Supreme Court precedents, the D.C. Circuit instead struck the single offending clause from the CFPB's implementing legislation and rendered the director removable by the President at will, rather than for good cause. Id. at 37-39.

Thus, contrary to the dissent's suggestions, the majority's opinion portends no change to any ALJ's robust protections. The dissent states that all *1,792* federal ALJs are removable only by the United States Merit Systems Protect Board (MSPB), "and only for good cause." Dissent at 14. Assuming *arguendo* that is always correct, see 5 U.S.C. § 7521, cursory research on this un-briefed issue reveals that the MSPB is composed of *three* members, each of whom are appointed directly by the President but removable only for good cause. 5 C.F.R. § 1200.2. So even if this court were faced with the hypothetical future case that troubles the dissent, there is no cause for alarm that the administrative state will be eroded (and of course, that is of no import to whether the government is following Article II). See Free Enterprise Fund, 561 U.S. at 499. A court faced with such a challenge would be empowered only to order the minimal remedy effective to cure the Article II error, id. at 508-10: rendering the MSPB's three members removable by the President at will. While the dissent opines on the hypothetical consequences of the majority's opinion, today's decision will have *none* of the consequences to the nationwide civil service that the dissent predicts.

Additionally, the dissent is incorrect when it argues that the majority is not showing appropriate "deference to Congress," Dissent at 16, on this structural constitutional question, as when it states: "Whether federal ALJs should receive such dual for-cause protections is perhaps a question that could be debated, but Congress has already decided this question in favor of protecting ALJs . . . ." Id. at 14 n.8. Freytag rejected this exact argument and recognized that "[t]he structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic." 501 U.S. at 880. With respect to removal specifically, even if Congress sought to insulate all federal ALJs from Executive control by placing them behind double layers of good-cause removal protection, Free Enterprise Fund holds that a court would be obliged to afford that decision *no* deference and instead to strike the unsound architecture. 561 U.S. at 497.

In any event, the dissent's dire predictions about hypothetical consequences of the majority's holding are exaggerated.

II

Turning to the dissent's proposal for deciding this case on the facts here, the dissent appears to *sub silentio* urge this court to adopt Landry and Lucia's misstatement of Freytag's test for determining whether a federal employee is an inferior Officer. That is, the dissent focuses almost exclusively on whether the SEC's ALJs exercise final decisionmaking authority, calling it the "[m]ost important[]" consideration that "makes all the difference" in deciding whether the ALJs are Officers. Dissent at 1 (citing, *inter alia*, Lucia, 832 F.3d

at 285-87); see id. at 6 n.2 (arguing that "[d]elegated sovereign authority has long been understood to be a key characteristic of a federal 'office'"); id. at 7-8 (contending, absent citation to authority, that this question "is not about" the SEC's delegation to its ALJs of "day-to-day discretion" because "the Appointments Clause does not care about *that*").

But as the majority points out, this mode of analysis —and the D.C. Circuit's repeated application of it—is wrong. Freytag instead compels courts, as the majority does here, to examine all of the "duties and functions" a federal employee has been delegated and then to determine whether that person is exercising the authority of the United States (an Officer) or simply carrying out "ministerial" government tasks (an employee). 501 U.S. at 881-82. Here, the distinction is exemplified by whether the government employee in question was engaged in the ministerial task of transcribing the record at Mr. Bandimere's hearing or was the person who decided on behalf of the United States that his testimony there was not believable and in what respects, critical issues to determining whether he ought to incur civil penalties. See id.

Likewise, final decision-making authority is but one sovereign power, albeit an important one that is typically *sufficient* to render an employee an Officer. See, e.g., id. at 882. Though final decision-making authority might be *sufficient* to make an employee an Officer, that does not mean such authority is *necessary* for an employee to be an Officer, contrary to the dissent's suggestion and Lucia's holding—by its refusal to consider any of the SEC's ALJs' other duties and functions. 832 F.3d at 285. Conducting the correct, nuanced anal-

ysis of the powers Congress by statute and the SEC by rule and practice have afforded its ALJs, the majority correctly reasons that the SEC's ALJs exercise significant authority and are thus inferior Officers, subject to the Appointments Clause. The dissent therefore errs —as do Landry and Lucia—by applying a truncated version of Freytag's legal framework.

Further, even as to its analysis of the SEC's ALJs' decision-making authority, the dissent mischaracterizes the factual record in a manner that it is imperative to correct. Specifically, the dissent states and then repeatedly relies on the fact that the SEC is not required to afford its ALJs any deference and that it conducts de novo review of their decisions to conclude that the ALJs do not "have the sovereign power to bind the Government and third parties." Dissent at 1. The dissent also calls this a "difference that makes all the difference" between the SEC's ALJs and "the special trial judges at issue in" Freytag. Id.

The dissent additionally states that "even where special trial judges" in Freytag "could not enter binding decisions, their initial decisions had binding effect" because the Tax Court was "*required* to presume correct" their "factual findings, including findings of intent, and to defer to [a] special trial judge's determinations of credibility." Id. at 2 (citations omitted). The dissent is undoubtedly correct that "[s]uch deference was a delegation of significant authority to the special trial judges." Id. As the dissent goes on to explain, "[m]any cases before the Tax Court . . . involve critical credibility assessments, rendering the appraisals of the special trial judge who presided at trial vital to the Tax Court's ultimate determination. And . . .

findings of fact often conclusively decide tax litigation, as they did in" Freytag. Id. at 2-3(quotation marks, alteration, and citation omitted). The dissent is also correct that, "it cannot be reasonably disputed that findings of fact 'may well be determinative of guilt or innocence.'" Id. (quoting Napue v. Illinois, 360 U.S. 264, 269 (1959)). Indeed, as Napue emphasized, assessing the "truthfulness and reliability of a given witness" during live testimony is one such critical factual determination. 360 U.S. at 269.

The dissent rightly points out that if an agency deferred to its personnel on such critical issues, "the Appointments Clause would be offended." Dissent at 5 n.1. But the dissent then applies these statements in an attempt to distinguish the special trial judges imbued with that authority from the SEC's ALJs: "The Securities and Exchange Commission, by contrast, is not required to give its ALJs any deference" and "may review its ALJs' conclusions of law and findings of fact de novo." Id. at 6. At the same time, however, the dissent admits that the "SEC may sometimes defer to the credibility determinations of its ALJs." Id. at 7 n.3. And the dissent does not attempt to reconcile that concession with its earlier-stated admission that credibility assessments may be outcome determinative. Lucia relied in part on this same distinction. 832 F.3d at 286 (stating that the SEC conducts "*de novo* review" of its ALJs' decisions); id. at 288 (stating that the SEC "reviews an ALJ's decisions *de novo*," but acknowledging that the SEC "may sometimes defer to the credibility determinations of its ALJs," and citing Landry, 204 F.3d at 1133, and the SEC's own regulations and orders sanctioning this practice).

This characterization of the SEC's actual process of reviewing its ALJs' decisions is wrong, notwithstanding its attempt to characterize its review as "de novo." David F. Bandimere, SEC Release No. 9972, 2015 WL 6575665, at *20 (Oct. 29, 2015). In footnotes 83 and 114 of its opinion in Mr. Bandimere's case, the SEC reveals the full effect of affording its ALJs the very deference that the dissent explains runs afoul of the Appointments Clause. Id. at *15 n.83, *20 n.114. Specifically, the SEC determined that Mr. Bandimere's "falsely telling [Mr.] Loebe that excess profits would go to a Christian charity rather than to pay him [was] evidence of [his] intent to deceive." Id. at *15. In making that determination, the SEC explained that Mr. "Bandimere testified that he did not remember making this statement to [Mr.] Loebe, but the ALJ found [Mr.] Loebe's testimony more credible than [Mr.] Bandimere's as to this issue." Id. at *15 n.83. Then, instead of rendering its own credibility determination with respect to the conflicting testimony, the SEC applied its rule that "[a]n ALJ's credibility findings are entitled to considerable weight." Id. (citations omitted). The SEC thus engages in deferential, not de novo review of key aspects of its ALJs' decisions.

The SEC admitted as much when it addressed Mr. Bandimere's Appointments Clause challenge. It professed to review its "ALJs' decisions de novo." Id. at *20. The dissent simply takes the SEC at its word. Yet the SEC added the following caveat to that statement: "We do not view the fact that we accord Commission ALJs deference in the context of demeanor-based credibility determinations to afford our ALJs with the type of authority that would qualify them as inferior officers." Id. at *20 n.114. The SEC at-

tempted to shore up its conclusion on this Article II question with the disclaimer that it "will disregard explicit determinations of credibility when [its] de novo review of the record as a whole convinces [it] that a witness's testimony is credible (or not) or that the weight of the evidence warrants a different finding as to the ultimate facts at issue." Id. (quotation marks and citations omitted).

But that proviso is cold comfort to a defendant, like Mr. Bandimere, whose liability for massive civil penalties depends in no small part on the United States's assessment of his credibility during live testimony, credibility determined by the only government employee designated to preside over that testimony—an ALJ. And whatever the SEC means by its disclaimer, it does not equate to de novo review. Rather, whether the SEC disagrees with its ALJs' credibility determinations triggers its own rule that an ALJ's evaluation of a witness's live testimony is entitled to "considerable weight." Id. at *15 n.83. Thus, at minimum, the SEC's ALJs exercise significant discretion over issues of credibility, unchecked by faux "de novo" review.

As the dissent concedes, affording bureaucrats such deference permits them to exercise the sovereign authority of the United States in an often-outcome-determinative fashion that is incompatible with the Appointments Clause. Therefore, even under the dissent's (and Lucia's) truncated Freytag analysis, the majority correctly holds that the SEC's ALJs are inferior Officers.

15-9586, Bandimere v. SEC

McKay, Circuit Judge, dissenting

Notwithstanding the majority's protestations otherwise, today's opinion carries repercussions that will throw out of balance the teeter-totter approach to determining which of all the federal officials are subject to the Appointments Clause. While the Supreme Court perhaps opened the door to such an approach in *Freytag v. Commissioner*, 501 U.S. 868 (1991), I would not throw it open any further, but in my view that is exactly what the majority has done. I do not believe *Freytag* mandates the result proposed here, and the probable consequences are too troublesome to risk without a clear mandate from the Supreme Court. I respectfully dissent.

The majority compares SEC ALJs to the Tax Court's special trial judges, and it reasons that because the duties of an ALJ are enough like those of a special trial judge, ALJs must be "Officers" too. But the similarities between *Freytag* and this case matter far less than the differences. Most importantly, the special trial judges at issue in *Freytag* had the sovereign power to bind the Government and third parties. SEC ALJs do not. And under the Appointments Clause, that difference makes all the difference. *See Officers of the United States Within the Meaning of the Appointments Clause*, 31 Op. O.L.C. 73, 73-74 (2007); *Raymond J. Lucia Companies v. SEC*, 832 F.3d 277, 285-87 (D.C. Cir. 2016).

The requirements of the Appointments Clause are "designed to preserve political accountability relative to important Government assignments." *Edmond v.*

United States, 520 U.S. 651, 663 (1997). It ensures that members of the executive branch cannot "escape responsibility" for significant decisions by hiding behind unappointed officials or otherwise "pretending that" those decisions "are not [their] own." *Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 497 (2010). Such government officials—"those who exercise the power of the United States"—must be "accountable to the President, who himself is accountable to the people." *Dep't of Transp. v. Ass'n of Am. R.Rs.*, 135 S. Ct. 1225, 1238 (2015) (Alito, J., concurring).

It is not surprising, then, that the Tax Court's special trial judges were held to be officers in *Freytag*. 501 U.S. at 881-82. It is clear from the context, if not the *Freytag* opinion, that these special trial judges had been delegated significant authority—much more authority than SEC ALJs. In some cases, special trial judges could enter final decisions on behalf of the Tax Court. *Freytag*, 501 U.S. at 882. In those cases, it was conceded in *Freytag* that the special trial judges acted as inferior officers. *Id.* But even where special trial judges could not enter final decisions, their initial decisions had binding effect.

Where the special trial judges did not issue a final decision, the Tax Court was still *required* to presume correct the special trial judge's factual findings, including findings of intent, and to defer to the special trial judge's determinations of credibility. *See Landry v. FDIC*, 204 F.3d 1125, 1133 (D.C. Cir. 2000). Such deference was a delegation of significant authority to the special trial court judges. Many cases before the Tax Court, including the ones at issue in *Freytag*, "involve critical credibility assessments, rendering the

appraisals of the [special trial] judge who presided at trial vital to the Tax Court's ultimate determinations." *Ballard v. Comm'r*, 544 U.S. 40, 60 (2005). In *Ballard*, for example, "[t]he Tax Court's decision repeatedly [drew] outcome-influencing conclusions regarding the credibility of Ballard . . . and several other witnesses." *Id.* And as the *Freytag* petitioners argued, "[f]indings of fact often conclusively decide tax litigation, as they did in [that] case. Pet'rs' Br. at 23, *Freytag v. Comm'r*, 501 U.S. 868 (1991) (No. 90-762), 1991 WL 11007938. Thus, even when the special trial judge was not authorized to enter a final decision, his initial report often decided the case. The majority says this overstates the role of special trial judges, but it cannot be reasonably disputed that findings of fact "may well be determinative of guilt or innocence." *Napue v. Illinois*, 360 U.S. 264, 269 (1959).

The majority barely mentions that the Tax Court was "required to defer" to the special trial judges' factual and credibility findings "unless they were clearly erroneous." *Landry*, 204 F.3d at 1133. But the powers of the special trial judges must be understood in context. As *Freytag* illustrates, a special trial judge's initial decision is not like an ALJ's—it is the difference between chiseling in stone and drafting in pencil.

The majority also fails to appreciate that the Tax Court appeared to defer to its special trial judges on conclusions of law as well. But this point was squarely before the Supreme Court. As the *Freytag* petitioners argued, "[i]n practice, special trial judge factual findings and legal opinions are routinely adopted verbatim by the regular Tax Court judges to whom they

are assigned." Brief for Petitioner, *supra*, at 7. Between 1983 and 1991, when *Freytag* was decided, every initial report submitted by a special trial judge was purportedly adopted verbatim—a fact made known to the *Freytag* Court. *See* Pet'rs' Br., *supra*, at 6-10.

Every reported decision, including the Tax Court's decision in *Freytag*, "invariably beg[an] with a stock statement that the Tax Court judge 'agrees with and adopts the opinion of the special trial judge.'" *Ballard*, 544 U.S. at 46 (citation omitted) (original brackets omitted); *see, e.g.*, *Freytag v. Comm'r*, 89 T.C. 849, 849 (1987) ("The Court agrees with and adopts the opinion of the Special Trial Judge that is set forth below."). Following that disclaimer was an opinion issued in the name of the special trial judge.

Freytag thus illustrates another point that the majority misses: the Tax Court may not have even reviewed the supposedly nonfinal decisions of its special trial judges. As the *Freytag* petitioners argued before the Supreme Court, that case was "a perfect example of how special trial judges routinely do the Tax Court's work with only the most cursory supervision, if any." Pet'rs' Br., *supra*, at 23. There, "after one of the longest trials in Tax Court history," which involved "14 weeks of complex financial testimony spanning two years of trial" and which produced "9,000 pages of transcript and . . . 3,000 exhibits," the Tax Court purported to adopt the special trial judge's report—verbatim—and filed it as the Tax Court's decision on the very same day it received the report. *Id.* at 23, 9. As the *Freytag* petitioners argued to the Supreme Court, "[t]he special trial judge's filing of his report and its verbatim adoption by [Tax Court] Chief Judge

Sterrett appear from the record to have been virtually simultaneous." *Id.* at 8. That decision resolved several unsettled, important legal questions. Yet, according to the docket, the Tax Court judge filed the decision as his own on the same day that the special trial judge filed his proposed findings and opinions. *See id.*[1]

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[1] The majority's emphasis on *Ballard* is misplaced; that case has little to do with the question before us. In *Ballard*, a case decided 14 years after *Freytag*, the government averred that a Tax Court special trial judge's report was treated as an "in-house draft to be worked over collaboratively by the regular [Tax Court] judge and the special trial judge." *See* 544 U.S. 40, 57. The majority puts this averment forward as fact, but the *Ballard* Court "[did] not know what happened in the Tax Court, a point that is important to underscore here." *Ballard*, 544 U.S. at 67 (Kennedy, J., concurring). Indeed, the Court could not have known: the special trial judges' initial reports were not disclosed even to the Supreme Court. As the concurring opinion clarified, *Ballard* should be interpreted "as indicating that there might be such a practice, not that there is." *Id.* The majority ignores this. The majority also fails to explain why *Ballard* should color an interpretation of *Freytag* when the purported practice had not yet been disclosed, let alone put in front of the *Freytag* Court.

The majority next states that there is "no indication" the Tax Court judge in *Freytag* adopted the STJ's report "verbatim"—but the Tax Court judge purported to do just that. *Freytag*, 89 T.C. at 849. Indeed, "[i]n the 880 cases heard between . . . 1983 and . . . 2005, there appear to be no instances in which a special trial judge issued a report and recommendation that the Tax Court publicly modified or rejected." Christopher M. Pietruszkiewicz, *Conflating Standards of Review in the Tax Court: A Lesson in Ambiguity*, 44 Houston L. Rev. 1337, 1360 (2008). What's more, after *Ballard* was decided, the Tax Court tried to make good by releasing the undisclosed reports from every case heard initially by a special trial judge since 1983. Louise Story, *Tax Court Lifts Secrecy, Putting Some Cases in New Light*, N.Y. Times, Sept. 24,

The *Freytag* petitioners' point was that special trial judges had as much authority as Tax Court judges themselves. The petitioners referred to them as "full-fledged surrogates for the Tax Court judges," who "exercise virtually the same powers as presidentially-appointed Tax Court judges." *Id.* at 12, 27. The Supreme Court, then, was thoroughly briefed on the true power of the special trial judges: In some cases, special trial judges could enter final decisions on behalf of the Tax Court. In others, special trial judges had, by rule, near-final say on outcome-determinative facts. And in practice they had de facto power "to issue findings and opinions that may be adopted verbatim by the Tax Court without meaningful review even in the most complex, significant and far-reaching cases, as they were [in *Freytag*]." *Id.* at 27. Thus, the special trial judges exercised "significant authority pursuant to the

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2005, at C6. It could find initial reports in only 117 of the 923 cases. *Id.* Of those 117 cases, the Tax Court modified the special trial judges' recommendations only 4 times. *Id.* Such figures demonstrate the level of deference afforded to special trial judges.

Following its lengthy discussion of the Tax Court's purported collaborative practice, the majority says "[w]hat really counts . . . are the STJs features the Supreme Court relied on" in *Freytag*. Maj. Op. at 35. But *Freytag* did not "rely" on this purported practice—indeed; it had not yet been disclosed by the Tax Court. Taking the majority at its word, its own reliance on *Ballard* seems out of place. Instead, we should look to what was actually before the *Freytag* Court.

In any event, whether the Tax Court in practice deferred to the special trial judges on both facts and law, or whether it directed the outcome of a case while escaping responsibility by disclaiming the decision is a distinction without a difference. Either way, the Appointments Clause would be offended.

laws of the United States." *Freytag*, 501 U.S. at 881 (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976)).[2]

The majority says that "SEC ALJs closely resemble the STJs described in *Freytag*." Maj. Op. at 21. But that is simply not the case. The Securities and Exchange Commission, by contrast, is not required to give its ALJs any deference. The Commission may review its ALJs' conclusions of law and findings of fact de novo. 17 C.F.R. § 201.411(a). It employs ALJs in its discretion, and all final agency orders are those of the Commission, not of its ALJs. An ALJ serving as a hearing officer prepares only an "initial decision." *Id.* § 201.360(a)(1). And at any time during the administrative process, the Commission may "direct that any matter be submitted to it for review." *Id.* § 201.400(a). The Commission thus "retains plenary authority over the course of its administrative proceedings and the rulings of its law judges—both before and after the issuance of the initial decision and irrespective of whether any party has sought relief." Mendenhall, Exchange Act Release No. 74532, 2015 WL 1247374, at *1 (Mar. 19, 2015).[3]

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[2] Put another way, the special trial judges had been delegated a portion of the sovereign powers of the federal government; they could act on behalf of the Tax Court, and they had the power to bind third parties and the government itself. *See Lucia*, 832 F.3d at 285. Delegated sovereign authority has long been understood to be a key characteristic of a federal "office." *See* 31 Op. O.L.C. 73 (reviewing historical precedents leading up to *Buckley*). And it is delegated sovereignty that is lacking here.

[3] It is true, as the majority points out, that the Commission may sometimes defer to the credibility determinations of its ALJs. But because the Commission has retained plenary authority over its ALJs, it is "not required to adopt the credibility determinations

On appeal, the Commission is not limited by the record before it. It "may expand the record by hearing additional evidence" itself or it may "remand for further proceedings." Bandimere, SEC Release No. 9972, 2015 WL 6575665 (Oct. 29, 2015) (internal quotation marks and brackets omitted). The Commission "may affirm, reverse, modify, set aside" the initial decision or remand, "in whole or in part," and it "may make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. § 201.411(a). If "a majority of participating Commissioners do not agree to a disposition on the merits, the initial decision shall be of no effect." *Id.* § 201.411(f).

The majority says that, like special trial judges, SEC ALJs also "exercise significant discretion." Maj. Op. at 19. But again the majority misses the point. It is not about day-to-day discretion—the Appointments Clause does not care about *that*. Special trial judges "exercise[d] significant discretion" in setting the record because the Tax Court was required to defer to its special trial judges' findings. We say, for example, that a "district court has significant discretion in sentencing" because we "review for abuse of discretion." *United States v. Tindall*, 519 F.3d 1057, 1065 (10th Cir. 2008); *see also, e.g.*, *Murphy v. Deloitte & Touche Grp. Ins. Plan*, 619 F.3d 1151, 1164 (10th Cir. 2010) (recognizing that a district court has "substantial discretion in handling discovery requests," because our

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of an ALJ." *Lucia*, 832 F.3d at 288 (citation omitted). By contrast, the Tax Court was *required* to defer to its special trial judges. In my estimate, this power to bind the government is, in large part, what separates "purely recommendatory power" from "significant authority," and ALJs from special trial judges.

standard of review is highly deferential). Similarly, a special trial judge had "significant discretion" because the Tax Court had to review its findings equally deferentially. The Commission, by contrast, does not have to review its ALJ's opinions with any deference. An SEC ALJ, thus, does not exercise "significant discretion" in any meaningful way.

SEC ALJs, then, possess only a "purely recommendatory power," *Landry*, 204 F.3d at 1132, which separates them from constitutional officers. The Supreme Court has suggested as much. *See Free Enter. Fund*, 561 U.S. at 507. In *Free Enterprise Fund*, the Court explained that its holding "does not address that subset of independent agency employees who serve as administrative law judges" and that "unlike members of the [Public Company Accounting Oversight] Board," who *were* officers, "many administrative law judges . . . perform adjudicative rather than enforcement or policymaking functions, or possess purely recommendatory powers." *Id.* at 507 n.10 (citation omitted).

The results speak for themselves: Unlike the Tax Court, which purported to adopt its special tax judges' opinions verbatim in 880 out of 880 cases between 1983 and 2005, the Commission followed its ALJs' recommendations in their entirety in only 3 of the 13 appeals decided thus far in 2016.[4] In the other 10 cases, the

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[4] *See* Grossman, Release No. 10227, 2016 WL 5571616 (Sept. 30, 2016); Schalk, Release No. 10219, 2016 WL 5219501 (Sept. 21, 2016); Cohen, Release No. 10205, 2016 WL 4727517 (Sept. 9, 2016); optionsXpress, Inc., Release No. 10125, 2016 WL 4413227 (Aug. 18, 2016); Gonnella, Release No. 10119, 2016 WL 4233837 (Aug. 10, 2016); Aesoph, Release No. 78490, 2016 WL 4176930 (Aug. 5, 2016); Malouf, Release No. 10115, 2016 WL 4035575 (July 27, 2016); J.S.

Commission disagreed with its ALJs for various reasons: In one case, the Commission reversed its ALJ because the SEC Enforcement Division failed to meet its burden; in another, it held that civil penalties, which the ALJ had recommended, were not available due to the statute of limitations.

In the end, then, it is the Commission that "ultimately controls the record for review and decides what is in the record." *Lucia*, 832 F.3d at 288 (citation omitted); *see also Nash v. Bowen*, 869 F.2d 675, 680 (2d Cir. 1989) (recognizing that, under 5 U.S.C. § 557(b), the agency "retains 'all the powers which it would have in making the initial decision'"). It is the Commission that enters the final order—in all cases—and it is the commissioners who shoulder the blame.

The majority argues that the current process for selecting ALJs "does not lend itself to . . . accountability," Maj. Op. at 23, but it is quite clear where the buck stops. Because the Commission is not bound in any way by its ALJ's decisions, unlike the Tax Court, the blame for its unpopular decisions will fall squarely on the commissioners and, in turn, the president who appointed them. So long as the commissioners have been validly appointed, the Appointments Clause is satisfied.

Putting aside that the Commission is not bound—in any way—by an ALJ's recommendations, amici's at-

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Oliver Capital Management, L.P., Release No. 10100, 2016 WL 3361166 (June 17, 2016); Riad, Release No. 78049, 2016 WL 3226836 (June 13, 2016); Page, Release No. 4400, 2016 WL 3030845 (May 27, 2016); Doxey, Release No. 10077, 2016 WL 2593988 (May 5, 2016); Young, Release No. 10060, 2016 WL 1168564 (March 24, 2016); Wulf, Release No. 77411, 2016 WL 1085661 (Mar. 21, 2016).

tempt to analogize SEC ALJs to magistrate judges only serves to highlight the difference between ALJs and constitutional officers. Unlike ALJs, magistrate judges have been delegated sovereign authority and have the power to bind the government and third parties. Magistrate judges are authorized to issue arrest warrants, 18 U.S.C. § 3041; determine pretrial detention, *id.* §§ 3141, 3142; detain a material witness, *id.* § 3144; enter a sentence for a petty offense, without the consent of the United States or the defendant, 28 U.S.C. § 636(a)(4); and issue final judgments in misdemeanor cases and all civil cases with the consent of the parties, *id.* §636(a)(5), (c); 18 U.S.C. §3401. Magistrate judges may also impose sanctions for contempt. 28 U.S.C. § 636(e). SEC ALJs can do none of these things.

The majority's reliance on Supreme Court decisions from the nineteenth century and early twentieth century is equally problematic. The majority's casual citation to these cases might lead one to believe there is a body of caselaw to which we can analogize. But these decisions "often employed circular logic, granting officer status to an official based in part upon his appointment by the head of a department." *Landry*, 204 F.3d at 1132-33. For example, *United States v. Mouat*, 124 U.S. 303 (1888), cited by the majority, held that "[u]nless a person . . . holds his place by virtue of an appointment by the President, or of one of the courts of justice or heads of Departments authorized by law to make such an appointment, he is not, strictly speaking, an officer of the United States." *Id.* at 307; s*ee also Free Ent. Fund*, 561 U.S. at 539 (Breyer, J., dissenting) (quoting commentary that described "early precedent as 'circular' and [the Court's] later law as 'not particularly useful'").

Finally, I began this dissent by expressing my fears of the probable consequences of today's decision. It does more than allow malefactors who have abused the financial system to escape responsibility. Under the majority's reading of *Freytag*, all federal ALJs are at risk of being declared inferior officers. Despite the majority's protestations, its holding is quite sweeping, and I worry that it has effectively rendered invalid thousands of administrative actions. Today's judgment is a quantitative one—it does not tell us how much authority is too much. It lists the duties of SEC ALJs, without telling us which, if any, were more important to its decision than others and why. And I worry that this approach, and the end result, leaves us with more questions than it answers.

Are all federal ALJs constitutional officers? Take, for example, the 1,537 Social Security Administration (SSA) ALJs,[5] who collectively handle hundreds of thousands of hearings a year.[6] SSA ALJs, like SEC ALJs, are civil service employees in the "competitive service" system. 5 C.F.R. § 930.201(b). In addition to presiding over sanctions actions, which are adversarial, *see* 20 C.F.R. § 404.459, SSA ALJs conduct non-adversarial hearings to review benefits decisions, *see id.* §§ 404.900, 405.1(c), 416.1400. In these proceedings,

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[5] *See* Office of Pers. Mgmt., *ALJs by Agency*, https://www.opm.gov/services-foragencies/administrative-law-judges/#url=ALJs-by-Agency (last visited Oct. 31, 2016). According to the Office of Personnel Management's latest count, there are 1,792 total federal administrative law judges. *Id.*

[6] *See* SSA, *Annual Performance Report 2014-2016*, Table 3.1h, at 82, available at http://www.ssa.gov/agency/performance/2016/FINAL_2014_2016_APR_508_compliant.pdf.

the claimant may appear, submit evidence, and present and question witnesses. *Id.* §§ 404.929, 404.935, 416.1429, 416.1435. Like SEC ALJs, SSA ALJs "regulate the course of the hearing and the conduct of representatives, parties, and witnesses." *Id.* § 498.204(b)(8). Like SEC ALJs, SSA ALJs administer oaths and affirmations, *see id.* § 404.950, and examine witnesses, *id.* § 498.204(b)(9). Like SEC ALJs, SSA ALJs may receive, exclude, or limit evidence. *Id.* § 498.204(b)(10).

If a claimant is dissatisfied with an SSA ALJ's decision, he may seek the SSA's Appeals Council's review. The Appeals Council may then deny or dismiss the request for review or grant it. *Id.* §§ 404.967, 416.1467. Like the Securities and Exchange Commission, the Appeals Council may also review an ALJ's decision on its own motion. *Id.* §§ 404.969(a), 416.1469(a). After it has reviewed all the evidence in the ALJ's hearing record and any additional evidence received, the Appeals Council will make a decision or remand the case to an ALJ. *Id.* §§ 404.977, 404.979, 416.1477, 416.1479. The Appeals Council may affirm, modify or reverse the ALJ's decision. *Id.* If no review is sought and the Appeals Council does not review the ALJ's decision on its own motion, the ALJ's decision becomes final. *See id.* §§ 404.955, 404.969, 416.1455, 416.1469.

This should all sound familiar. SSA ALJs have largely the same duties as SEC ALJs, and the appeals process appears similar as well. But the parallels between SEC ALJs and SSA ALJs do not end there. Like SEC ALJs, SSA ALJs can hold prehearing conferences, *id.* § 405.330; punish contemptuous conduct by excluding a person from a hearing, *see* Social Security Administration Hearings, Appeals and Litigation

Law Manual (HALLEX), I-2-6-60 (Jan. 15, 2016)[7]; rule on dispositive and procedural motions, 20 C.F.R. § 498.204(b); rule on sanctions, *see* HALLEX, I-2-10-16; and take depositions, *see* HALLEX, I-2-6-22. Like SEC ALJs, an SSA ALJ "may, on his or her own initiative or at the request of a party, issue subpoenas for the appearance and testimony of witnesses and for the production of books, records, correspondence, papers, or other documents that are material to an issue at the hearing." 20 C.F.R. § 404.950. Like SEC ALJs, though, SSA ALJs cannot enforce or seek enforcement of a subpoena; the SSA itself would have to get an order from a federal district court to compel compliance. *See* 42 U.S.C. § 405(e).

This is all to say that SEC ALJs are not unique. I cannot discern a meaningful difference between SEC ALJs and SSA ALJs under the majority's reading of *Freytag*. Indeed, litigants have already begun drawing this precise comparison between SEC ALJs and SSA ALJs. *See, e.g., Manbeck v. Colvin*, No. 15 CV 2132 (VB), 2016 WL 29631 (S.D.N.Y. Jan. 4, 2016). Insofar as SSA ALJs are not appointed by the president, a court of law, or the head of a department, *cf. O'Leary v. Office of Pers. Mgmt.*, No. DA-300A-12-0430-B-1, 2016 WL 3365404 (M.S.P.B. June 17, 2016), today's decision risks throwing much into confusion. "Does every losing party before an ALJ now have grounds to appeal on the basis that the decision entered against him is unconstitutional?" *Free Enter. Fund*, 561 U.S. at 543 (Breyer, J., dissenting). It certainly seems that way.

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[7] Available at https://www.ssa.gov/OP_Home/hallex/hallex-I. html.

And what of the ALJs going forward? When understood in conjunction with *Free Enterprise Fund*, I worry today's opinion will be used to strip ALJs of their dual layer for-cause protection. In *Free Enterprise Fund*, the Supreme Court held that "dual for-cause limitations on the removal" of some inferior officers is unconstitutional. 561 U.S. at 492. Presently, SEC ALJs (and SSA ALJs) have such dual for-cause protection: An SEC ALJ may only be removed by the Merit Systems Protection Board and only for good cause. *See* 5 U.S.C. § 7521(a), (b). The members of the Merit Systems Protection Board are themselves protected from at-will removal. *Id.* at § 1202. I appreciate that this issue is not before the court, but today's decision makes it more likely that either ALJs or the Board, or both, will lose this civil service protection. *See Free Enter. Fund.*, 561 U.S. 477, 542, 525 (2010) (Breyer, J., dissenting).[8]

I am similarly concerned about what the majority's decision portends for untold rules and regulations. "Although almost all rulemaking is today accomplished through informal notice and comment, the APA actually contemplated a much more formal process for most rulemaking. To that end, it provided for elaborate trial-like hearings in which proponents of particular rules would introduce evidence and bear the burden of proof in support of those proposed rules." *Perez v.*

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[8] Whether federal ALJs should receive such dual for-cause protections is perhaps a question that could be debated, but Congress has already decided this question in favor of protecting ALJs, and the majority opinion shows little concern for the way its decision will overturn congressional intent and disrupt a system that has been in place for decades.

Mortg. Bankers Ass'n, 135 S. Ct. 1199, 1222 n.5 (2015) (Thomas, J., concurring) (citing 5 U.S.C. § 556).

Formal rulemaking proceedings must be presided over by an agency official or an ALJ. An ALJ's function in formal rulemaking is nearly identical to its function in formal adjudications. *See* 5 U.S.C. §§ 556, 557. So, if ALJs are officers for purposes of formal adjudication, as the majority so holds, they must also be officers for formal rulemaking. *See also Freytag*, 501 U.S. at 882 ("Special trial judges are not inferior officers for purposes of some of their duties under § 7443A, but mere employees with respect to other responsibilities. . . . If a special trial judge is an inferior officer for purposes of subsections (b)(1), (2), and (3), he is an inferior officer within the meaning of the Appointments Clause and he must be properly appointed."). Though formal rulemaking is much rarer today, *see Perez* 135 S. Ct. at 1222 n.5, this was not always the case. And I worry that rules and regulations that were promulgated via formal rulemaking before an agency ALJ and are still enforced today are now constitutionally suspect.[9]

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[9] Some of these questions could, perhaps, be resolved by an explicit statement that the opinion does not apply retroactively. *See e.g., Buckley*, 424 U.S. at 142 (holding that the appointment of some Commissioners violated the Appointments Clause, but that the "past acts of the Commission are therefore accorded de facto validity," even though "[t]he issue [was] not before [the Court]." *Id.* at 744 (Burger, C.J., concurring in part and dissenting in part)). *But see* Maj. Op. 36 ("Questions about . . . retroactivity are not issues on appeal . . . . we must leave for another day any putative consequences of [our] conclusion.'").

Today's holding risks throwing much into disarray. Since the Administrative Procedures Act created the position of administrative law judge in 1946, the federal government has employed thousands of ALJs to help with the day-to-day functioning of the administrative state. *Freytag*, which was decided 25 years ago, has never before been extended by a circuit court to any ALJ. And yet, the majority is resolved to create a circuit split. When there are competing understandings of Supreme Court precedent, I would prefer the outcome that does the least mischief.

Furthermore, faced with such uncertainty, "we must hesitate to upset the compromises and working arrangements that the elected branches of Government themselves have reached." *NLRB v. Noel Canning*, 134 S. Ct. 2550, 2560 (2014). Judicial review must fit the occasion. In a close case regarding the application of a constitutional rule in a discrete factual setting, and without much precedent to guide us, deference to Congress seems particularly relevant. I respectfully dissent.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 15-9586
(SEC No. 3-15124)
(Securities & Exchange Commission)

DAVID F. BANDIMERE, PETITIONER

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

IRONRIDGE GLOBAL IV, LTD;
IRONRIDGE GLOBAL PARTNERS, LLC, AMICI CURIAE

[Filed: Dec. 27, 2016]

JUDGMENT

Before BRISCOE, MCKAY, and MATHESON, Circuit Judges.

This petition for review originated from the United States Securities and Exchange Commission and was argued by counsel.

It is the judgment of this Court that the SEC ALJ held his office unconstitutionally when he presided over

Mr. Bandimere's Hearing. The petition for review is granted and the SEC's opinion is set aside.

Entered for the Court

/s/ ELISABETH A. SHUMAKER
ELISABETH A. SHUMAKER, Clerk

APPENDIX C

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 9972 / Oct. 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76308 / Oct. 29, 2015

Admin. Proc. File No. 3-15124

In the Matter of DAVID F. BANDIMERE

OPINION OF THE COMMISSION

SECURITIES ACT PROCEEDING

EXCHANGE ACT PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Unregistered Offer and Sale of Securities

Unregistered Broker

Fraud

An individual, acting as an unregistered broker, offered and sold shares in securities in the form of investment contracts when no registration statement was filed or in effect as to those securities and no exemption from registration was available; in offering and selling those securities, the individual made positive statements about the securities while failing to disclose material information necessary to make his statements not misleading. *Held*, it is in the public interest to bar

the respondent from associating with a broker, dealer, investment adviser, municipal securities dealer, or transfer agent; order the respondent to cease and desist from committing or causing any violations or future violations of the provisions violated; order disgorgement of $638,056.33, plus prejudgment interest; and assess a civil money penalty of $390,000.

APPEARANCES:

David A. Zisser, Jones & Keller, P.C., for David F. Bandimere.

Dugan Bliss and *Thomas J. Krysa*, for the Division of Enforcement.

Appeal filed: Oct. 28, 2013

Last brief received: Apr. 3, 2014

David F. Bandimere appeals from the initial decision of an administrative law judge[1] in a proceeding brought pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934[2] and based on allegations that Bandimere violated securities registration, broker registration, and antifraud provisions of the federal securities laws. The ALJ found that Bandimere operated as an unregistered broker and sold securities in the

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[1] *David F. Bandimere*, Initial Decision Release No. 507, 2013 WL 5553898 (Oct. 8, 2013).

[2] 15 U.S.C. §§ 77h-1, 78*o*(b), 78u-3. The proceeding was also brought pursuant to Section 9(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-9(b), and Sections 203(f) and (k) of the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-3(f), (k). The Division decided not to pursue its alternative theory of liability under the Advisers Act.

form of investment contracts when no registration statement was filed or in effect as to those investments and no exemption from registration was available. Additionally, the ALJ found that Bandimere presented only a positive view of the investments while failing to disclose potentially negative facts related to the investments, including the fact that he was receiving substantial payments based on the investments he had sold. In so doing, the ALJ found, Bandimere violated antifraud and registration provisions of the federal securities laws. The ALJ found it in the public interest to bar Bandimere from association with a broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; to order that Bandimere to disgorge $638,056.33 plus prejudgment interest; to impose a civil penalty of $390,000; and to order Bandimere to cease and desist from committing or causing violations of the provisions in question.

We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. We find, as did the ALJ, that Bandimere violated Sections 5(a), 5(c), and 17(a) of the Securities Act; Sections 10(b) and 15(a) of the Exchange Act; and Exchange Act Rule 10b-5.[3] Additionally, we reject as meritless both Bandimere's claim that the Commission violated his right to equal protection of the law when it brought this matter in an administrative forum, and that the proceeding is constitutionally defective because the presiding ALJ was not appointed in accordance with the Appointments Clause of the

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[3] 15 U.S.C. §§ 77e(a), 77e(c), 77q(a); 78j(b), 78*o*(a); and 17 C.F.R. § 240.10b-5.

U.S. Constitution. We also reject Bandimere's challenge to evidentiary rulings by the ALJ and his request for additional discovery. Finally, we find that a bar, cease-and-desist order, disgorgement, and civil penalties are in the public interest, but we modify the bar imposed by the ALJ.

I. BACKGROUND

The charges in this matter are based on Bandimere's involvement in selling investments in IV Capital LTD ("IVC") and Universal Consulting Resources LLC ("UCR"). Having received some funds from the sale of a family business, Bandimere mentioned to Richard Dalton, a friend of many years, that he was looking for a place to invest the money and would like to know if Dalton had heard of anything promising. Dalton told Bandimere that he had brought together some investors who were investing with Larry Michael Parrish, a principal of IVC, and that he was getting paid for handling distribution of checks and other tasks for Parrish. In late 2005, Bandimere began investing with Parrish, and by the middle of 2006, he began arranging for others to invest in IVC through his personal account, receiving fees from IVC based on their investments in compensation for his efforts. In 2007, working with an attorney who also had invested in IVC (and later in UCR), Bandimere formed limited liability companies through which people could invest in IVC, continuing to receive fees on a monthly basis based on the amounts they invested. Also in 2007, Dalton set up an investment vehicle of his own, UCR, and Bandimere began arranging for people to invest in it, also through the LLCs. As was the case with IVC, Bandimere received payments from UCR on a monthly basis

based on the amounts people invested in UCR through him.

Although the OIP did not allege that Bandimere knew so at the time of his alleged misconduct, both IVC and UCR turned out to be Ponzi schemes, run by Parrish and Dalton respectively. Both men were charged with operating a Ponzi scheme and violating securities registration, antifraud, and broker-dealer registration provisions of the securities laws, and judgment was ultimately entered against both men in separate actions in federal district court. In those proceedings, Parrish and Dalton were permanently enjoined and ordered to disgorge millions of dollars in ill-gotten gains and to pay an equal amount in civil penalties.[4]

But this case is not about whether Bandimere was the perpetrator of a Ponzi scheme, nor does it turn on whether Bandimere had actual knowledge that IVC and UCR were Ponzi schemes. This case is about whether Bandimere (1) sold securities for which no registration statement was in effect (and no exemption

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[4] *SEC v. Parrish*, No. 11-cv-00558-WJM-MJW, 2012 WL 4378114 (D. Colo. Sept. 25, 2012) (order granting plaintiff's motion for default judgment); *SEC v. Universal Consulting Res. LLC*, No. 10-cv-02794-REB-KLM, 2011 WL 6012532 (D. Colo. Dec. 1, 2011) (order granting motion for default judgment against Richard Dalton and permanent injunction); *SEC v. Universal Consulting Res. LLC*, No. 10-cv-02794-REB-KLM, 2011 WL 6012536 (D. Colo. Dec. 1, 2011) (order granting motion for default judgment against Universal Consulting Resources LLC and permanent injunction). In a subsequent criminal action based on Dalton's involvement with UCR, Dalton plead guilty to one count of money laundering and was sentenced to a prison term of 120 months, to be followed by three years of supervised release. *United States v. Dalton*, 11-cr-00430-CMA-01 (D. Colo. June 30, 2013) (entry of amended judgment).

from registration applied), (2) operated as an unregistered broker, and (3) fraudulently omitted from the representations he made to investors material information about IVC and UCR that he, in fact, did know—regardless of the fact that they were Ponzi schemes. For the reasons explained below, we find that Bandimere violated Section 5 of the Securities Act by offering and selling unregistered securities, violated Section 15 of the Exchange Act by acting as unregistered broker, and violated antifraud provisions of the Securities Act and Exchange Act by failing to disclose material information that was necessary to make his representations to investors not misleading.

II. REGISTRATION AND BROKERAGE VIOLATIONS

A. Facts

1. Bandimere invested his own money in IVC, then arranged for other to invest.

Bandimere, a resident of Golden, Colorado, has never been registered with the Commission as a broker, a dealer, or an investment adviser, nor has he been associated with a registered broker, dealer, or investment adviser. In 2005, Dalton, a long-time friend, introduced Bandimere to Parrish. As Bandimere understood it, Dalton was working for Parrish and was getting paid for his efforts to recruit investors to IVC, an off-shore company with operations in Nevis of which Parrish was a principal. Parrish told Bandimere that IVC traded primarily in securities, currencies, and commodities, that he personally had about $22 million invested in IVC, and that those funds were tied into a hundred-million dollar trading block out of Hong Kong.

Parrish also told Bandimere that funds sent to IVC would be held in escrow and used as collateral for a loan, with the loan proceeds, rather than the escrowed funds, being used for trading. Bandimere understood —and later told investors—that IVC would be using pooled investor funds for trading, that the efforts of IVC's traders would determine whether IVC was profitable or generated any returns for investors, and that investors would have no role in determining the trades that IVC made. Additionally, Parrish told Bandimere that IVC would earn at least a 5% return each month, which would be evenly divided between IVC and its investors. Bandimere made an initial investment of $100,000 with IVC in November 2005, and then invested an additional $100,000 in 2006.

Bandimere told some friends and family members about his IVC investments, and in 2006, he helped some of them invest in IVC under his name. IVC sent the purported returns to Bandimere, and Bandimere distributed them to the investors who had invested through him.

Parrish and Bandimere agreed that Parrish would compensate Bandimere for his involvement with IVC. Compensation was set at a rate of 10% of the monthly returns to investors. In addition to signing up investors for IVC, Bandimere (1) answered their questions about the investment and explained how it worked, (2) asked investors to fill out paperwork, (3) sent investor funds to IVC, (4) calculated returns due to investors,[5] (5) received checks from IVC ostensibly

[5] Bandimere calculated returns for each investor based on the amount invested. The formula was generally 2% or 2.5% per month

representing IVC's returns, and (6) distributed those "returns" to investors. He also provided information about how to invest retirement funds in IVC.

Rather than continuing to facilitate investment in IVC under his own name, Bandimere worked with attorney Cameron Syke in early 2007 to form two LLCs, Exito Capital LLC[6] and Victoria Capital LLC, which he began using to solicit investments in IVC. Bandimere was a comanaging member, together with Syke, of Exito,[7] and was the managing member of Victoria. Bandimere subsequently formed a third LLC, Ministry Minded Investors LLC. Bandimere served as the managing member of Ministry Minded. Investors wrote their checks to one of Bandimere's LLCs, but the LLCs were merely means to get their investments into IVC.[8] By the time the IVC scheme collapsed, the LLCs had collected over $5.6 million in investor funds for IVC (excluding Bandimere's investment).

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for IVC investors. The purported returns were calculated with reference to the amount invested rather than on any alleged profits.

[6] Syke testified that he intended to limit membership in Exito to a small group of investors with a specified level of wealth. Syke understood that interests in the LLCs were securities, and he hoped that by structuring Exito this way he could avoid potential issues involving the unregistered sale of securities.

[7] Syke testified that his role with respect to Exito primarily involved settling up the LLC, addressing legal matters, and overseeing tax treatment, and that Bandimere and Bandimere's wife managed the day-to-day operations, including interacting with Parrish and Dalton, receiving and depositing investor funds, and distributing investor returns. Syke and Bandimere split the fees Parrish paid for their efforts with respect to Exito.

[8] None of the three LLCs was registered with the Commission as a broker, dealer, or investment adviser.

Bandimere introduced IVC to potential investors at social gatherings, such as church retreats, breakfasts, and club meetings. He also hosted several meetings for potential investors in his home.

2. Bandimere invested in, then helped others invest in, UCR.

In early 2008, Bandimere began investing in UCR and encouraging others to do so. UCR was a New Mexico limited liability company with its principal place of business at Dalton's home in Golden, Colorado. According to Dalton, UCR engaged in international trading in notes and diamonds. As Bandimere described the trading program to potential investors, it involved using the accumulated funds of multiple investors, which would allow leverage and increase buying power, so as to allow small investors to participate in deals that would otherwise not be available to them. As was the case with respect to IVC, Bandimere understood (and told investors) that UCR would pool investor funds to make investments, that the profitability of UCR depended on the traders' efforts, and that investors played no role in determining the investments that UCR made.

Initially, Bandimere offered only the opportunity to invest in UCR's trading program, but later he also began offering an opportunity to invest in UCR's diamond program. Bandimere's role in facilitating investments in UCR through the LLCs was essentially the same as his role in facilitating investment in IVC; he signed up investors, answered their questions about the investments and explained how they worked, sent investor funds to UCR, received checks ostensibly representing UCR's returns, distributed those "returns"

to investors, and provided information about investing retirement funds in UCR.[9] Dalton agreed to pay Bandimere 2% of the total amount of investor funds each month for his efforts in connection with UCR. Overall, investments in UCR's trading and diamond programs through the LLCs (excluding Bandimere's own investments) were over $3.4 million.

B. Analysis

1. Bandimere violated Securities Act Sections 5(a) and (c) by offering and selling investments in securities in interstate commerce when no registration statement was in effect and no exemption from registration applied.

We find that Bandimere violated Sections 5(a) and 5(c) of the Securities Act by selling interests in the IVC and UCR programs, which were securities, when no registration statement was in effect for those securities and no exemption from registration applied.[10] The elements necessary to establish a prima facie case against Bandimere for violating Sections 5(a) and (c) are that (1) Bandimere directly or indirectly sold or offered to sell securities; (2) through the use of interstate facilities or the mails; (3) when no registration

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[9] For UCR investors, Bandimere calculated returns of 4% per month for the UCR trading program. Returns in the UCR diamond program were projected to be higher, 15% of the amount invested or even more, but those returns were to be paid when a transaction was allegedly completed rather than on a monthly basis. As with IVC, the purported returns were calculated with reference to the amount invested.

[10] *See* 15 U.S.C. §§ 77e(a), 77e(c); *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 WL 32121, at *7 (Jan. 6, 2012), *petition denied*, 739 F.3d 1243 (9th Cir. 2014).

statements was in effect or filed as to those securities.[11] There is no requirement to prove that Bandimere acted with scienter.[12] Once a prima facie case is established, the burden shifts to the respondent to show that an exemption from the registration requirements applies.[13] In this case, Bandimere does not contend that any exemption to registration applies. We must therefore examine whether the elements of a prima facie violation have been established. As discussed below, we find that they have and that Bandimere is thus liable for violating Section 5.

a. The IVC and UCR investments were unregistered securities.

The interests Bandimere sold in IVC and UCR were investment contracts and thus securities. Both Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act provide that an investment contract is a type of security.[14] Although neither statute defines the term "investment contract," the Supreme Court in *SEC v. Howey* supplied a widely-used test for an investment contract: "whether the scheme involves

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[11] *See World Trade Fin. Corp.*, 2012 WL 32121, at *7; *SEC v. Cavanaugh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006); *SEC v. Calvo*, 378 F.3d 1211, 1214-15 (11th Cir. 2004).

[12] *See Calvo*, 378 F.2d at 1215; *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1046-47 (2d Cir. 1976).

[13] *See SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1086 (9th Cir. 2010); *Cavanaugh*, 445 F.3d at 111 n.13 (citing *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953)).

[14] 15 U.S.C. §§ 77b(a)(1), 78c(a)(10). The Supreme Court has stated that although the definitions in the two acts use slightly different formulations, they are treated as "essentially identical in meaning." *SEC v. Edwards*, 540 U.S. 389, 393 (2004).

an investment of money in a common enterprise with profits to come solely from the efforts of others."[15] The Court in *Howey* explained that an investment contract typically involves a situation in which "[t]he investors provide the capital and share in the earnings and profits [while] the promoters manage, control and operate the enterprise."[16] The *Howey* test "'embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'"[17]

The interests in IVC and UCR that Bandimere sold satisfy the *Howey* test because the investors supplied money to Bandimere—first through his personal account and later through the LLCs—to purchase investments in IVC and UCR and expected their financial return to come through the business activities of IVC and UCR, not through their own participation. [18]

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[15] 328 U.S. 293, 301 (1946).

[16] *Id.* at 300.

[17] *Edwards*, 540 U.S. at 393 (quoting *Howey*, 328 U.S. at 299).

[18] The investments Bandimere sold in IVC and UCR are, in fact, quite similar to the investment at issue in *People v. White*, 12 P.2d 1078, 1079 (Cal. Dist. Ct. App. 1932), a case cited in *Howey* as having correctly interpreted the term "investment contract." 328 U.S. at 298 n.4. In *White*, the promoter used the investor's $5,000 to trade in securities and agreed to pay the investor the return of principal plus 50% annual interest. This is functionally identical to the interests Bandimere sold to investors. No pooling of funds from multiple investors was present in *People v. White* and we have previously held that a "common enterprise"—often established through pooling of multiple investors' funds—is not a distinct requirement under *Howey*. *See, e.g.*, *Johnny Clifton*, Exchange Act Release No. 69982, 2013 WL 3487076, at *8 n.55 (July

Bandimere testified that he sent investor funds—first from his personal account and later from the LLCs—to a bank account for either IVC or UCR, as directed by investors.[19] Bandimere understood at the time, and told investors that, IVC would use the pooled funds of investors in its trading program. He also told investors that UCR would use pooled investor funds in either its trading operation or its diamond operation. Bandimere also testified that he told investors that the efforts of IVC or UCR (or their traders) would determine whether the entities were profitable or generated any profits for investors; investors would have no role in determining the trades that IVC or UCR made. No investor testified that he or she played any role in the management of IVC or UCR, the entities' trading decisions or how profits were earned by either entity. In fact, all the investors who were asked about such involvement testified that they played no such role.

For these reasons, we conclude that the interests Bandimere sold in the IVC and UCR programs were investment contracts, and thus securities within the meanings of the Securities Act and the Exchange Act.[20]

12, 2013); *Joseph Abbondante*, Exchange Act Release No. 53066, 2006 WL 42393, at *6 n.40 (Jan. 6, 2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006); *Anthony H. Barkate*, Exchange Act Release No. 49542, 2004 WL 762434, at *3 n.13 (Apr. 8, 2004), *aff'd*, 125 F. App'x 892 (9th Cir. 2005). Nonetheless, if a common enterprise were a separate requirement for an investment contract, here pooling of investor funds establishes that a common enterprise was present. *See Clifton*, 2013 WL 3487076, at *8 n.55.

[19] IRA funds went first to an intermediary, then to an LLC, then to IVC or UCR.

[20] Our finding that the investments in IVC and UCR were securities also applies to our analyses in parts II.B.2 and III below.

Bandimere does not dispute this conclusion. Furthermore, the parties stipulated that neither the IVC nor the UCR investments were ever registered with the Commission.

b. Bandimere used interstate facilities in the offer and sale of the IVC and UCR investments.

There is also no dispute that the jurisdictional nexus is satisfied in this case. The required interstate nexus is de minimis and is satisfied by even "tangential mailings or intrastate telephone calls."[21] Bandimere wired money to IVC and UCR, sent checks representing investor returns through the mails, and used the telephone, faxes, and email to communicate with Parrish and with investors. Accordingly, we find that this

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[21] *SEC v. Softpoint, Inc.,* 958 F. Supp. 846, 861 (S.D.N.Y. 1997) (finding that defendant's telephone conversations with various brokerage firms and defendant's wire and mail transfers of funds satisfied the Section 5 jurisdictional requirement), *aff'd*, 159 F.3d 1348 (2d Cir. 1998); *see also United States v. Wolfson*, 405 F.2d 779, 784 (2d Cir. 1968) (finding that the use of the mails to "'transmit an offer or other sales literature, to transport the securities after sale, to remit the proceeds to the seller, to send confirmation slips to the buyer,'" and perhaps even more tangential uses of the mails, can all satisfy the jurisdictional requirement of Section 5(a)(1) (quoting *United States v. Kane*, 243 F. Supp. 746, 750 (S.D.N.Y. 1965))); *McDaniel v. United States*, 343 F.2d 785, 787-88 (5th Cir. 1965) (noting that use of the mails to send a confirmation of a sale to a buyer of stock constituted a use of the mails within the meaning of Section 5); *SEC v. Reynolds,* No. 1:06-CV1801-RWS, 2010 WL 3943729, at *3 (N.D. Ga. Oct. 5, 2010) (finding that the jurisdictional requirements of section 5(a) and 5(c) were established where defendant used mail, telephone and internet to sell securities).

conduct satisfied the Section 5 jurisdictional requirement of use of interstate commerce or of the mails.[22]

c. Bandimere acted as a statutory seller in offering and selling the IVC and UCR investments.

Bandimere argues that he did not violate Section 5 because he was not a "seller" of securities for purposes of the Securities Act. Relying on the Supreme Court's decision in *Pinter v. Dahl*,[23] Bandimere argues that "a seller of securities [does] not include someone not motivated to serve the financial interest of either the issuer of the securities or his own financial interest," and that his motivation in informing potential investors about IVC and UCR was to benefit those potential investors rather than serve his own financial ends. This argument is both factually and legally flawed. The

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[22] Bandimere's use of the phone, mail, fax, and email also satisfies the interstate commerce requirement for Sections 15(a), 17(a), 10(b), and Rule 10b-5. *See generally* T. Hazen, Treatise on the Law of Securities Regulation § 17.2 (available on WESTLAW at FEDSECREG) (noting that the jurisdictional requirements of the Securities Act and the Exchange Act are easily satisfied and that "[i]t is very difficult to imagine a securities transaction that does not in some respect involve an instrumentality of interstate commerce"). *See also, e.g., Softpoint*, 958 F. Supp. at 865 (stating that the defendant's use of the mails and facilities of interstate commerce, which satisfied the jurisdictional requirements of Section 5 of the Securities Act, also satisfied the jurisdictional requirements of Sections 17(a), 10(b) and Rule 10b-5); *Myzel v. Fields*, 386 F.2d 718, 727-28 (8th Cir. 1967) (finding sufficient evidence of interstate transactions for purposes of Section 10 and Rule 10b-5 through telephone calls and the interstate delivery of checks); *Clifton*, 2013 WL 3487076, at *8 (holding that the jurisdictional requirements of § 17(a) are "interpreted broadly" and may be satisfied by "intrastate telephone calls and ancillary mailings").

[23] 486 U.S. 622 (1988).

record shows that although a desire to help others may have played some part, Bandimere's actions were not motivated solely by a desire to help others. That Bandimere entered into agreements with Parrish and Dalton through which he earned nearly three-quarters of a million dollars by selling and managing IVC and UCR investments demonstrates a strong personal financial motive.[24]

More fundamentally, however, *Pinter* is not controlling here. In *Pinter*, the Court construed Securities Act Section 12(1), which created a private right of action for violations of Section 5. Section 12(1) makes "[a]ny person who . . . offers or sells a security in violation of Section [5] . . . liable to the person purchasing such security from him."[25] The Court made clear that its holding on the liability of a "seller" was limited to the private action created by Section 12(1) and specifically relied on "the second clause of § 12(1), which provides that only a defendant 'from' whom the plaintiff 'purchased' securities may be liable, [thus] narrow[ing] the field of potential sellers."[26] By contrast, Section 5 lacks the "purchasing . . . from" language

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[24] The Court in *Pinter* suggested that someone who "*received* a personal financial benefit from the sale" would qualify as a seller. 486 U.S. at 654 (emphasis added). The Court also questioned the Respondent's argument that he was "motivated entirely by a gratuitous desire to share an attractive investment opportunity with his friends and associates," and directed the court of appeals to examine the issue more closely on remand. *Id.* at 655. Bandimere here negotiated for and received substantial compensation for facilitating the investments of others in IVC and UCR, and we accordingly find that he was motivated by this financial interest.

[25] *Id.* at 627 (quoting Securities Act Section 12(1), 15 U.S.C. § 77*l*(1)).

[26] *Id.* at 643.

or any equivalent found in Section 12(1), imposing liability instead on those who "directly or indirectly" offer or sell securities. The greater reach of Section 5 in this regard makes the interpretation of "seller" in *Pinter* inapplicable to Bandimere's situation. As the United States Court of Appeals for the District of Columbia Circuit held in *SEC v. Zacharias*, "[a]s § 5 does *not* include the 'purchas[e] . . . from' language or any equivalent, *Pinter* is plainly of no use" to an individual charged with a Section 5 violation.[27]

Indeed, under both Commission and federal court precedents, Section 5 liability is based on whether a person is a substantial factor or a necessary participant in an offer or sale,[28] and *Pinter* did nothing to disturb this line of authority.[29] In light of his extensive involvement in the offer and sale of the IVC and UCR investments as set forth above, we find that for the sales at issue in this case Bandimere was a both a substantial factor and a necessary participant for purposes of Section 5.

For the above reasons, we find that Bandimere violated Sections 5(a) and (c) of the Securities Act.

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[27] 569 F.3d at 466-67.

[28] *See John A. Carley*, Securities Exchange Act Release No. 57246 (Jan. 31, 2008), 2008 WL 268598, at *10; *Zacharias v. SEC,* 569 F.3d 458, 464 (D.C. Cir. 2009); *SEC v. Phan*, 500 F.3d 895, 906 (9th Cir. 2007); *Calvo*, 378 F.3d at 1215; *SEC v. Holschuch*, 694 F.2d 130, 139-40 (7th Cir. 1982).

[29] *See Phan*, 500 F.3d 895, 906 n.13 (noting that "Section 5 contains no language similar to the 'from him' language of Section 12," and thus "*Pinter* did not overturn" that court's "necessary participant"/"substantial factor" test for Section 5 liability).

2. Bandimere violated Exchange Act Section 15(a) by acting as an unregistered broker.

We also find that Bandimere violated Section 15(a) of the Exchange Act[30] by selling and attempting to sell interests in the IVC and UCR programs, which were securities, when he was neither registered nor associated with a registered broker-dealer. Section 15(a)(1) makes it illegal for a broker to use the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (with limited exceptions not applicable here) unless the broker is either registered with the Commission or a natural person associated with a registered broker.[31] Section 3(a)(4)(A) of the Exchange Act generally defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others."[32] A finding of violation of Section 15(a) does not require proof of scienter.[33]

Bandimere stipulated that he had never been registered with the Commission as a broker, dealer, or investment adviser and had never been associated with a broker, dealer, or investment adviser. Moreover, as we have already found, the investments in IVC and UCR were securities. Thus, whether Bandimere violated Section 15(a) depends on whether he engaged in

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[30] 15 U.S.C. § 78*o*(a).

[31] *Id.* § 78*o*(a)(1).

[32] 15 U.S.C. § 78c(a)(4)(A).

[33] *See, e.g.*, *SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003); *SEC v. Interlink Data Network*, 1993 WL 603274, at *10 (C.D. Cal. 1993); *SEC v. Nat'l Exec. Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980).

the business of effecting transactions in the IVC and UCR investments for the accounts of others. As explained below, we find that Bandimere acted as a broker and thus violated Section 15(a).

a. Bandimere was engaged in the business of effecting securities transactions for others' accounts.

In determining whether a person is "engaged in the business" of effecting transactions for others' accounts, the courts and the Commission have considered a number of factors. A primary consideration is whether there has been regular participation in securities transactions at key points in the chain of distribution.[34] The number of customers at issue,[35] the dollar amount

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[34] *SEC v. Bravata*, 2009 WL 2245649, at *2 (E.D. Mich. July 27, 2009); *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, at *12 (D.D.C. 1998); *see also SEC v. Coplan*, 2014 WL 695393, at *6 (S.D. Fla. Feb. 24, 2014) (recognizing importance of regularity of participation in Section 15(a)(1) analysis); *SEC v. Benger*, 697 F. Supp. 2d 932, 944 (N.D. Ill. 2010) (same); *SEC v. Martino*. 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003) (same); *SEC v. Corporate Relations Grp.*, 2003 WL 25570113, at *17 (M.D. Fla. Mar. 28, 2003) (same); *SEC v. Interlink Data Network*, 1993 WL 603274, at *10 (C.D. Cal. Nov. 15, 1993) (same); *SEC v. Margolin*, 1992 WL 279735, at *5 (S.D.N.Y. Sept. 30, 1992) (same); *SEC v. Nat'l Exec. Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980) (same); *UFITEC v. Carter*, 571 P.2d 990, 994 (Ca. 1977) (same); *Mass. Fin. Servs., Inc. v. SIPC*, 411 F. Supp. 411, 415 (D. Mass) (same), *aff'd*, 545 F.2d 754 (1st Cir. 1976); *Wheat, First Sec. Inc.*, Exchange Act Release No. 48378, 2003 WL 21990950, at *11 n.49 (Aug. 20, 2003) ("A person 'effects' securities transactions by participating in such transactions 'at key points in the chain of distribution.'" (quoting *Mass. Fin. Servs.*, 411 F. Supp. at 415)).

[35] *See Kenton Capital*, 69 F. Supp. 2d at 13 (finding broker status established where those found to be brokers received pledges to in-

of transactions,[36] and the number of transactions effected[37] have all been recognized as indicia of regularity of participation. Bandimere was responsible for sales to more than 60 customers, involving more than $9,000,000 in numerous transactions over three years. This conduct demonstrates regularity of participation.

Consistent with the practice of federal courts, we also consider a variety of additional factors in determining whether a person acted as a broker. Among the factors considered are whether the person actively solicited or recruited investors; advised investors as to the merits of an investment, or opined on its merits; or received commissions, transaction-based compensation, or payment other than a salary for selling the investments.[38] Other factors that have been viewed as relevant include whether the person was an employee of the issuer of the securities; was selling, or had previously sold, the securities of other issuers; or was involved in negotiations between the issuer and the in-

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vest from more than forty individuals and actually collected money from twelve investors).

[36] *See id.* (finding that individuals who received pledges to invest totaling $17,450,000 and actually collected $1,745,000 acted as brokers); *Nat'l Exec. Planners*, 503 F. Supp. at 1073 (finding regularity of participation established where sales totaled $4.3 million); *UFITEC*, 571 P.2d at 994 (finding regularity of participation where sales totaled several million dollars).

[37] *See SEC v. Margolin*, 1992 WL 279735, at *5 (S.D.N.Y. 1992) (regularity of participation found where individual "participated in dozens of transactions for various clients").

[38] *See SEC v. Hansen*, 1984 WL 2413, at *10 (S.D.N.Y. Apr. 6, 1984); *Coplan*, 2014 WL 695393, at *6; *Corporate Relations Grp.*, 2003 WL 25570113, at *17.

vestor.[39] Whether the individual handled customer funds and securities has also been viewed as important.[40] This is not an exhaustive list of the relevant factors, and no one factor is dispositive.[41]

In this matter, Bandimere's conduct is consistent with many of the factors recognized as important in the analysis of broker status. He solicited investors by informing them of the IVC and UCR investments, and talking about their merits, in a variety of contexts. Bandimere advised investors about the merits of the investments by emphasizing the rate and consistency of returns, the safety of principal, and the expertise of Parrish and Dalton,[42] and by providing descriptions as to how the programs supposedly worked. He assisted investors with the paperwork involved in investing and obtained their signatures on documents,[43] and he answered investors' questions. He handled both money

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[39] *See Hansen*, 1984 WL 2413, at *10 (citation omitted); *Benger*, 697 F. Supp. 2d at 944-45; *Martino*, 255 F. Supp. 2d at 283.

[40] *See SEC v. M&A West, Inc.*, 2005 WL 1514101, at *9 (N.D. Cal. June 20, 2005) (noting fact that no assets were entrusted to individual as factor of particular import in reaching conclusion that individual was not a broker); *Margolin*, 1992 WL 279735, at *5; *Benger*, 697 F. Supp. 2d at 945; *Martino*, 255 F. Supp. 2d at 283.

[41] *SEC v. Kramer,* 778 F. Supp. 2d 1320, 1334-35 (M.D. Fla. 2011); *SEC v. Benger*, 697 F. Supp. 2d 932, 945 (N.D. Ill. 2010).

[42] s*Cf. Coplan*, 2014 WL 695393, at *6 (finding that individual who promised investors that their principal would be secure and that they would make guaranteed returns advised investors as to merits of investments).

[43] Bandimere asserts in his opening brief that he "did not handle investor paperwork or obtain signatures for either IVC or UCR." But Bandimere's testimony at the hearing shows that he "handled paperwork necessary for people to invest in" IVC and UCR.

to be invested and returns to be paid to investors, and he helped investors put IRA funds in IVC and UCR.[44] At the hearing, he admitted that "from the beginning to the end, [he was] involved in the process of handling investments of [his] investors in [IVC] and UCR."

The receipt of transaction-based compensation in connection with the types of activities described above is often an indication that the recipient of that compensation is engaged in the business of effecting transactions in securities.[45] Although it is not required to establish broker status[46] and is not by itself determinative of broker status, we find that, here, Bandimere received transaction-based compensation because his compensation was based on the dollar amount of the original investment transactions (i.e., the amount he collected from investors to purchase interests in IVC and UCR). Bandimere calculated the amount owed to him

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[44] Bandimere admitted at the hearing that he accepted investors' money into the LLCs he managed or co-managed, that he sent money from the LLCs to IVC and UCR, that he sent money from the LLCs to the investors, and that he "handled" it when investors chose to channel IRA funds to IVC and UCR through another entity.

[45] *Order Exempting the Federal Reserve Bank of New York, Maiden Lane LLC and the Maiden Lane Commercial Mortgage Backed Securities Trust 2008-1 from Broker-Dealer Registration*, Exchange Act Release No. 61884, 2010 WL 1419216, at *2 (Apr. 9, 2010).

[46] *Warrior Fund*, 2010 WL 717795, at *3 n.8 ("[T]ransaction-based compensation is not a necessary element to determine whether someone is a broker."); *see also, e.g., SEC v. Imperiali*, 594 F. App'x 957, 961 (11th Cir. 2014) (finding that individual who spoke with investors, acted as the "closer" for his sales team, and drafted memoranda for potential investors acted as unregistered broker in violation of Section 15(a) without any reference to transaction-based compensation).

either as a percentage of the transaction itself, or as a percentage of "returns." But even where the amount was supposed to be a percentage of returns, since Bandimere had no evidence of any actual returns, he calculated his compensation by reference to the transaction amount, and what he thought the returns should have been based on that amount. In records he kept at the time, Bandimere often referred to the payments he received from IVC and UCR as "broker fees" or "commissions," suggesting that when he was involved with IVC and UCR, he viewed the payments as sales-related rather than administrative. As he admitted at the hearing, "the more investor funds . . . that [he] brought in, the more that those fee payments would be."

Based on our consideration of the relevant factors, we find that Bandimere was engaged in the business of effecting securities transactions for the account of others, and that he therefore acted as a broker within the meaning of Section 3(a)(4)(A).

b. Bandimere's arguments against Section 15(a) liability are without merit.

Bandimere makes several arguments against finding that he was acting as a broker. We find none of them convincing. He argues first that a number of the factors relevant to broker status do not apply to him. But courts have recognized that not all of the factors that have been identified as relevant need be present in order for us to find that someone acted as a broker.[47] The underlying facts vary widely from case to case, and

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[47] *See, e.g., Corporate Relations Grp.*, 2003 WL 25570113, at *18 (recognizing seven factors that may be relevant, but basing finding on only three).

there is no requirement that all the factors that have been recognized as relevant be present in any given case. In addition, because the analysis requires looking at all the circumstances, the factors considered in reaching a determination as to broker status in a particular case do not purport to be an exclusive list.[48] Indeed, the court in *SEC v. Benger*, on which Bandimere relies, rejected the argument that there is a binding and definitive set of factors needed to support a finding that a person acted as a broker. Rather, the court found that the Commission had sufficiently alleged broker status on facts similar to the facts we find in this matter: the individual collected investors' funds, received and processed documents related to the sale of the securities, communicated with the issuer about the receipt of funds and documents, and provided materials to the investors.[49]

Bandimere also argues that deciding broker status on a case-by-case basis without any analytical structure that provides predictability would be arbitrary and capricious. But the standard we use to determine broker status provides the requisite analytical structure. Although that standard includes the consideration of a non-exhaustive list of relevant factors, none of which is determinative, this does not render a decision based on that standard arbitrary. Unlike *Chekosky v. SEC*,[50]

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[48] *See Kramer,* 778 F. Supp. 2d at 1334; *Benger*, 697 F. Supp. 2d at 945.

[49] 697 F. Supp. 2d at 945. The Commission had also alleged that the person found to have acted as a broker in *Benger* received transaction-based compensation. *See id.*

[50] 23 F.3d 452 at 482 (D.C. Cir. 1994) (rejecting Commission's reliance on a negligence standard articulated in a Commission audi-

cited by Bandimere, the standard we apply here is one of long-standing in our opinions as well as those of federal courts.

We also reject Bandimere's argument that sanctioning him for violations of Section 15(a) would deny him due process because uncertainty as to what activities require registration as a broker creates a lack of notice of what the law requires. As noted, our determination that Bandimere acted as a broker is grounded on well-stablished criteria. Moreover, Bandimere's references to payments he received from IVC and UCR as "broker fees" suggest that he thought of himself as a broker.

Bandimere further argues that he did not receive transaction-based compensation but was paid for performing recordkeeping or other administrative functions. Bandimere's compensation was not related to any of the recordkeeping functions he performed but to the amount of the investments. Bandimere insists that if he was compensated simply for finding investors, there would have been no reason for him to spend the time and incur expenses performing administrative functions for no compensation. Even if Bandimere was compensated for administrative as well as sales activities, the *amount* of the compensation was transaction-based, and raised the investor protection concerns inherent in such compensation.[51]

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tor disciplinary opinion on the basis that the opinion relied on was not published or publically available).

[51] *See Order Exempting the Federal Reserve Bank of New York, Maiden Lane LLC and the Maiden Lane Commercial Mortgage Backed Securities Trust 2008-1 from Broker-Dealer Registration*, 2010 WL 1419216, at *2 & n.13 ("Compensation based on transactions in securities can induce high pressure sales tactics and other

For all of the above reasons, we find that Bandimere violated Section 15(a) of the Exchange Act.

III. FRAUD VIOLATIONS

Bandimere is charged with violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Section 17(a)(2) makes it "unlawful for any person in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[52] Section 10(b) makes it "unlawful for any person, directly or indirectly, . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules.[53] And Rule 10b-5(b) makes it unlawful, "in connection with the purchase or sale of any security," to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[54] A

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problems of investor protection which require application of broker-dealer regulation under the [Exchange] Act." (quoting *Persons Deemed Not To Be Brokers*, Exchange Act Release No. 22172, 1985 WL 634795, at *4 (June 27, 1985))).

[52] 15 U.S.C. § 77q(a).

[53] 15 U.S.C. § 78j(b).

[54] 15 U.S.C. § 78(j), 17 C.F.R. § 240.10b-5. Before the ALJ, the Division pursued liability under Section 17(a)(2) and Rule 10b-5(b), and not under Sections 17(a)(1) or (3) or Rule 10b-5(a) or (c). We limit our discussion here to the theories of liability pursued by the

violation of these provisions also requires the use of means or instrumentalities of interstate commerce.

We have already found that the investments in IVC and UCR at issue were securities, and that Bandimere used instrumentalities of interstate commerce to offer and sell them.[55] Bandimere does not deny that his statements about the IVC and UCR investments were made in connection with offers and sales of these investments. Moreover, he made the statements at issue directly to people who purchased, or who were offered the opportunity to purchase, those investments. This satisfies the "in connection with" requirement.[56] Accordingly, to find a violation of Section 17(a)(2) we must find that Bandimere "obtain[ed] money or property by means of" a material misrepresentation or omission and acted with at least negligence.[57] And to find a violation of

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Division in this case. In addition, although the OIP also charged violations of Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder, which prohibit fraudulent conduct by an investment adviser to a pooled investment vehicle, 15 U.S.C. § 80b-6(4), 17 C.F.R. § 275,206(4)-8, the Division stated in its post-hearing brief that it was not pursuing liability under the Advisers Act.

[55] *See supra* Sections II.B.1.a & b.

[56] *See, e.g.*, *SEC v. Jabukowski*, 150 F.3d 675, 680 (9th Cir. 1998) (statement made to induce acceptance of securities transaction satisfies "in connection with" requirement). *See also SEC v. Zandford*, 535 U.S. 813, 819-20 (2002) (finding that Commission "has consistently adopted a broad reading" of "in connection with" language in Section 10(b) and reiterating that Section 10(b) should be construed "'flexibly to effectuate its remedial purposes.'" (quoting *Affiliated Ute Citizens of the United States*, 406 U.S. 128, 151 (1972))).

[57] *See, e.g.*, *Thomas C. Bridge*, Exchange Act Release No. 60736, 2009 WL 3100582, at *13 n.59 (Sept. 29, 2009) ("There is no scienter

Section 10(b) and Rule 10b-5(b) we must find that Bandimere made a material misrepresentation or omission and acted with scienter.[58] We find by a preponderance of the evidence that these elements are satisfied.

A. Bandimere made materially misleading statements to investors.

As noted, Sections 17(a) and 10(b) and Rule 10b-5 may be violated by making untrue statements of material fact or by omitting a material fact necessary to make statements that are made, in light of the circumstances under which they were made, not misleading.[59] An omission is material if there is a substantial likelihood that a reasonable investor would have considered the omitted information important in deciding whether or not to invest and if disclosure of the omitted fact would have significantly altered the total mix of information available to the investor.[60] One who elects to disclose material facts "must speak fully and truthfully, and provide complete and non-misleading information

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requirement for violations of Securities Act Sections 17(a)(2) or (3); negligence is sufficient.").

[58] *See id.* at *13.

[59] 15 U.S.C. §§ 77q(a)(2), 78j(b); 17 C.F.R. § 240.10b-5(b). Bandimere contends that the ALJ failed to identify either material facts that caused particular statements to be misleading or positive information that was rendered misleading by omissions. Once we granted Bandimere's petition for review, the initial decision, including the factual findings made there, ceased to have any force or effect. *Richard J. Adams*, Exchange Act Release No. 39645, 1998 WL 52044, at *1 n.1 (Feb. 11, 1998). The findings set forth below are made as part of our de novo review.

[60] *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992).

with respect to the subjects on which he undertakes to speak,"[61] and incomplete disclosures "implicate a duty to disclose whatever additional information is necessary to rectify the misleading statements."[62] In addition, we have consistently recognized that making predictions and representations in connection with the offer or sale of a security, whether couched in terms of opinion or fact, which are without reasonable basis, violates the antifraud provisions of the securities laws.[63] Indeed, the Supreme Court recently recognized that a state-

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[61] *SEC v. Curshen*, 372 F. App'x 872, 880 (10th Cir. 2010); *see also Meyer v. JinkoSolar Holdings Co.*, 761 F.3d 245, 250-51 (2d Cir. 2014).

[62] *Schlifke v. Seafirst Corp.*, 866 F.2d 935, 944 (7th Cir. 1989).

[63] *See Robert G. Weeks*, 2004 WL 828, at *8-11 (baseless valuation of mining properties and mineral assets, baseless claims of revenue earned by smelter, and baseless representations that mines contained commercial values of ore all violated Section 17(a) and Section 10(b) and Rule 10b-5); *M.V. Gray Invs., Inc.*, Exchange Act Release No. 9180, 1971 WL 120492, at *3 (May 20, 1971) (president and principal shareholder of registered broker-dealer violated antifraud provisions when he made optimistic representations and predictions to customers without a reasonable basis, and knew, but did not tell customers to whom he recommended the stock, that the issuer had been losing money); *see also United States v. Ware*, 577 F.3d 442, 448-51 (2d Cir. 2009) (finding that issuance of press releases containing false and baseless statements supported findings of violation of Section 10(b) and Rule 10b-5); *SEC v. USA Real Estate Fund 1, Inc.*, 30 F. Supp. 3d 1026, 1035 (E.D. Wash. 2014) (finding that violations of Section 17(a), Section 10(b), and Rule 10b-5 were established by evidence that individual "repeatedly made material statements to investors that had no basis in reality and which he knew lacked any support"); *SEC v. Gebben*, 225 F. Supp. 2d 921, 926-27 (C.D. Ill. 2002) (finding that internet poster violated Section 10(b) and Rule 10b-5 by writing glowingly and authoritatively about a stock while having no independent basis for his opinions, but merely reciting what he was paid to say).

ment of opinion may be understood by a reasonable investor "to convey facts about how the speaker has formed the opinion—or, otherwise put, about the speaker's basis for holding that view. And if the real facts are otherwise, but not provided, the opinion statement will mislead its audience."[64]

1. Bandimere omitted material facts with respect to the IVC and UCR investments and obtained money by means of these omissions.

Bandimere made representations to investors about the investments in IVC and UCR that were materially misleading because he omitted facts that reasonable investors would have wanted to know when making the decision to invest. His positive representations about IVC included that Parrish was an expert trader with a professional and sophisticated trading organization, that the IVC investment principal would be deposited in a bank account and would be "borrowed against, but not at risk," that Bandimere had investigated IVC and was confident in the investment, and that investors could expect to receive returns of 2% to 2.5% per month. For UCR, Bandimere made similar representations: he told investors that the UCR programs involved professional organizations—including an experienced "secret" Singapore trader and a skilled diamond trader—and that UCR took care to safeguard investors' money. He also made representations about UCR's future returns, telling investors that their UCR trading program investment would yield 4% per month and that

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[64] *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 135 S. Ct. 1318, 1328 (2015).

the UCR diamond program would have a 25% return within a few months. All of these statements were materially misleading in light of the context in which they were made because Bandimere failed to disclose specific material facts in his possession about the investments that would have cast doubt on his positive representations.

Significantly, Bandimere failed to disclose that he was getting compensated by IVC and UCR at the respective monthly rates of 10% of ostensible investor returns and 2% of funds invested.[65] Bandimere's statements to potential investors that he was confident in the success of the investments and that they could expect to receive returns of 2% to 2.5% per month through IVC and 4% per month through UCR's trading program (as well as even greater returns through UCR's diamond program) were rendered materially misleading by his failure to disclose his own significant compensation, which was directly tied to the amount they invested. As we have noted, "[c]ourts have recognized that economic conflicts of interest, such as undisclosed compensation, are material facts that must be disclosed."[66]

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[65] Although the operating agreements for the Exito and Victoria LLCs contained a boilerplate provision that the managers of the LLCs would receive "reasonable compensation" for their services based on the "excess" of investor returns, Bandimere failed to tell investors that through explicit arrangements with Parrish and Dalton he was receiving significant payments directly from IVC and UCR—over three-quarters of a million dollars altogether—based on the amount of investments that he brought in.

[66] *IMS/CPAs & Assocs.*, Exchange Act Release No. 45019, 2001 WL 1359521, at *8 (Nov. 5, 2001) (citing additional authority); *see*

The disclosure in the LLC agreements was inadequate because it falsely suggested that Bandimere would be paid by the LLCs based on "excess" returns, not directly from IVC and UCR based on a pre-arranged percentage. It also failed to disclose the significant percentage Bandimere would receive of investors' purported returns and investments. This failure is a material omission because investors would have wanted to know, in order to properly assess Bandimere's positive representations about the investments' anticipated monthly returns, that Bandimere was being paid by IVC (10% of investor returns per month) and UCR (2% of total investments per month) for steering investors their way.

Bandimere's positive representations about the investments in IVC and UCR were also materially misleading because Bandimere failed to disclose negative facts which he knew about IVC, Parrish, UCR, and Dalton. Bandimere failed to tell investors specific negative information about Parrish. For example, Bandimere knew that Parrish had been sued by the Commission and failed to tell investors.[67] This made Bandi-

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also Curshen, 372 F. App'x at 881 (finding that where statements posted on the internet appeared to be relaying information about a security, disclosure of the fact that the person making the postings was compensated as a promoter of the stock would be necessary to make the statements not misleading).

[67] Bandimere admitted only to knowing that Parrish had an unspecified regulatory issue in 2004 or 2005 and testified that he was unclear as to whether the Commission was involved. But the ALJ found that Bandimere knew the Commission had brought suit against Parrish. Based our review of the evidence in the record, we agree with this finding

mere's statements about Parrish's trading acumen—that he was an "expert trader" and a "wizard at investing"—and that he ran a professional trading organization materially misleading. A reasonable investor would likely have found it significant that the federal regulatory agency charged with overseeing the securities industry found sufficient reason to charge the "expert trader" with violations of the federal securities laws and could have used the information to discover that Parrish had been charged with engaging in a fraudulent investment scheme, which in turn would have affected a reasonable investor's decision whether to invest in IVC.

In its action against Parrish, brought in federal district court in 2005, the Commission alleged that he and others engaged in a fraudulent "prime bank" investment scheme that raised $8.2 million from investors. *See generally SEC v. Parrish*, Litigation Release No. 20121, 2007 WL 1452643 (May 17, 2007) (describing litigation against Parrish). In May 2005, well before Bandimere had started investing with him or introducing other investors to UCR, Parrish had consented to a preliminary injunction and an asset freeze related to the "prime bank" scheme. *See SEC v. Z-Par Holdings, Inc.*, 05-CV-1031-JFM (D. Md. May 4, 2005) (preliminary injunction order); *SEC v. Z-Par Holdings, Inc.*, 05-CV-1031-JFM (D. Md. May 3, 2005) (notice of filing of agreed upon order). In April 2007, the court entered a final judgment against Parrish, imposing a permanent injunction by consent. *SEC v. Z-Par Holdings, Inc.*, 05-CV-1031-JFM (D. Md. Apr. 26, 2007) (final judgment as to defendant Larry Michael Parrish). In May 2007, Parrish settled an administrative proceeding brought against him based on his involvement in the same fraudulent scheme by consenting to the imposition of an order barring him from association with any broker or dealer, with a right to apply after at least five years. *Parrish*, 2007 WL 1452642.

Bandimere's representations about IVC as a professional trading organization were similarly misleading because he failed to qualify those representations with disclosures about IVC's failure to provide documents even after Bandimere asked for them and instances in which IVC sent less money than was due to the LLCs.[68] These omissions also rendered Bandimere's statements about the returns investors could expect to receive from IVC misleading—in part because IVC's failure to provide documents, or the right amount of money,[69] raised questions as to whether the alleged trades were taking place at all, much less yielding returns at the expected levels.

Despite Parrish's failure to provide Bandimere with basic documentation about IVC's operations, Bandimere told at least one investor that he had done some investigation into IVC and that he was confident in the investment. This statement was materially mislead-

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[68] IVC did not provide account statements documenting investments made through the LLCs or purported monthly earnings of the LLCs. Even when Bandimere asked for documents confirming trading, IVC's traders, or other aspects of the investments, Parrish did not provide them. Yet Bandimere did not tell investors about these gaps in documentation, or Parrish's refusal to provide the information Bandimere requested.

[69] Bandimere contends that the "Division presented only a single instance of Parrish sending insufficient funds," but there is evidence in the record, including Bandimere's own testimony, that Parrish repeatedly wired funds that were insufficient to cover both investor returns and Bandimere's expected commissions. Even if Parrish subsequently corrected the shortages, as Bandimere claims, the sloppiness of Parrish's operation exemplified by these repeated mistakes—which were never disclosed to investors—significantly undermines Bandimere's contrary representations about the professionalism and sophistication of IVC.

ing because Bandimere failed to disclose that his so-alled investigation was uncritically relying on unverified anecdotes from Parrish and others and that his confidence was largely baseless. For example, Bandimere testified that he had confidence in Parrish because he gave "a lot of credibility to a woman's sixth sense" and thus relied on Dalton's wife "comfort level" with Parrish. A reasonable investor would have wanted to know that Bandimere did almost nothing to investigate IVC and that he not only lacked a reasonable basis for the confidence he expressed but, in fact, knew facts that he did not share that would have seriously undermined that expression of confidence.

Bandimere also omitted material facts about UCR and Dalton, including concealing Dalton's identity from investors who knew Dalton personally. Bandimere's statements to Radke and Koch that UCR was headed by experienced and knowledgeable financiers and to Koch that the person in charge of UCR was a person of significant worldwide contacts and stature were materially misleading because he failed to identifying the head of UCR as Dalton—someone Bandimere knew they knew personally. Indeed, we find Bandimere's failure to tell Radke and Koch that Dalton was the person behind UCR highly material. Both Koch and Radke testified that they would have had concerns about investing with Dalton given his past, and Koch testified that he felt "betrayed" and that Bandimere "had not been straight" with him when he found out that the person behind UCR was Dalton. Bandimere's selective concealment of Dalton's involvement with UCR is itself strong evidence of the materiality of the information Bandimere chose to withhold.

To those investors who were unfamiliar with Dalton personally Bandimere failed to disclose specific facts he knew about Dalton's long history of unsuccessful business ventures. For example, Bandimere knew that Dalton had been involved in a failed investment venture involving debentures that resulted in investor losses of $2 to $3 million and a loss to Bandimere personally of over $10,000. He also knew that Dalton had been involved in several unsuccessful multilevel marketing businesses, one of which Bandimere believed went bankrupt and from another of which Bandimere assumed Dalton to have been dismissed. These omissions rendered Bandimere's statements to Davis and other investors that UCR was a sophisticated and professional organization and that Dalton had connections with experienced traders materially misleading.

Bandimere also misled investors by failing to notify them of the fact that Dalton never showed him any documentation about UCR, that Bandimere himself calculated the so-called investment returns, and that Dalton had to ask Bandimere for the amounts invested in UCR by the LLCs. The facts Bandimere omitted, which demonstrated an obvious lack of professionalism and, at the very least, hinted at possible dishonesty with respect to the UCR programs, were material because a reasonable investor would have considered the questions raised by the omissions significant in deciding whether to invest in those programs.

Finally, we find that Bandimere obtained money by means of the omissions described above, as required to find a violation of Section 17(a)(2).[70] As we have ex-

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[70] *See* 15 U.S.C. § 77q(a)(2).

plained, Bandimere's statements, which were rendered misleading by his omissions, were material in facilitating investments in IVC and UCR. Indeed, for those investors for whom Bandimere was the sole source of information about the investments, his misleading statements were the entire basis for their investment. Bandimere was compensated handsomely—receiving over three-quarters of a million dollars—based on the amount of money invested through him. This is more than sufficient to satisfy the requirement that he "obtain[ed] money . . . by means of" the omissions.[71] Accordingly, for all of the above reasons, we find that Bandimere's conduct satisfies the requirement for material misrepresentations or omissions under Securities Act Section 17(a)(2) and Exchange Act Section 10(b) and Rule 10b-5(b).

2. Bandimere's arguments that he did not materially mislead investors are without merit.

Bandimere argues that the OIP attributed to him only two representations about the IVC and UCR investments—that they were "low risk" and "very good investments." He asserts that there is no evidence that he made either statement, and that since the Division did not prove that he made either statement, any violations dependent on those statements must fail. We disagree.

The OIP alleges that Bandimere committed fraud because he

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[71] *See Clifton*, 2013 WL 3487076, at *9 (individual who received "override" of commissions generated on sale of securities obtained money for purposes of Section 17(a)(2)).

> presented a one-sided view and highlighted only positive material characteristics: a) the consistent rate of return, b) the established track record of performance, c) the experienced and successful traders, d) his personal dealings with Dalton and Parrish which gave him confidence in their abilities, and e) with regard to Dalton, his long-standing personal relationship.

Other paragraphs of the OIP provide more details about some of these representations. For example, the OIP alleges that Bandimere told investors that (1) the investment manager of the UCR trading program had been a longtime personal friend, (2) they would earn a guaranteed annual return of 48% on investments in the UCR trading program, (3) the UCR diamond program promised potential returns of 10% per month, and (4) the operating agreements for the LLCs specified annual targeted returns of 24-30%. Thus, contrary to Bandimere's insistence, he was put on notice from the outset as to the types of representations, and many of the specific representations, he was charged with having made. Moreover, as the Division points out in its response, witness testimony supports finding that he characterized the investments as low risk and very good investments, even if he did not use those exact words.[72] In addition, the OIP charged

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[72] *See* Tr. 305 (Loebe) ("I don't recall exact words. But the overall tone was that, here was a good investment."), Tr. 483 (Blackford affirmed that Bandimere told him that the "money was supposed to stay in some account, and then it would be borrowed against, but not at risk"), Tr. 537 (Davis) ("[H]e felt that it was a good investment and that he was—he was doing well with it."), Tr. 704 (when Bandimere "made the opportunity to known" to invest in IVC, he gave the impression to Radke "that it was a good investment"),

Bandimere with having "fail[ed] to disclose numerous red flags and potentially negative facts relating to those investments," specifically identifying fifteen instances of alleged failure to disclose.

Rule 200(b) of our Rules of Practice requires that the OIP state the nature of the hearing, the legal authority for holding the hearing, "a short and plain statement of the matters of fact and law to be considered and determined," and the nature of any relief sought."[73] But the OIP need not allege all of the evidence on which the Division intends to rely.[74] In determining whether a respondent in an administrative proceeding had adequate notices of the charges, the question is "whether the respondent 'understood the

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Tr. 757 (Bandimere suggested to Syke that for the UCR diamond program "there was really no risk, because it was done through the government").

[73] 17 C.F.R. § 201.200(b).

[74] *See Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at *14 (June 30, 2005) ("The OIP must inform the respondent of the charges in enough detail to allow the respondent to prepare a defense, but it need not disclose to the respondent the evidence upon which the Division intends to rely."), *petition denied*, 465 F.3d 780 (7th Cir. 2006); *M.J. Reiter Co.*, Exchange Act Release No. 6108, 1959 WL 59479, at *2 (Nov. 2, 1959) ("[A]ppropriate notice of proceedings is given when the respondent is sufficiently informed of the nature of the charges against him so that he may adequately prepare his defense[;] . . . he is not entitled to a disclosure of evidence."); *Charles M. Weber*, Exchange Act Release No. 4830, 1953 WL 44090, at *2 (Apr. 16, 1953) ("A respondent is not entitled to a disclosure of evidence in the order for hearing.").

issue' and was 'afforded full opportunity' to justify [his or her] conduct" during the course of the proceeding.[75]

Here, the OIP satisfied the requirements of Rule 200(b), and Bandimere was provided additional information through the Division's supplemental statement submitted in response to his motion for a more definite statement and throughout the course of the proceeding.[76] At the hearing, the Division introduced ample evidence of specific statements that Bandimere made about IVC and UCR, as discussed above, that created a one-sided positive view of the IVC and UCR investments. Thus, we reject Bandimere's argument that the Division was somehow required to prove that Bandimere made verbatim representations to investors that the IVC and UCR investments were "low risk" or "very good."

Bandimere also asserts that the only proven representations that he made about IVC and URC were statements about the investments' returns and that "[t]he accurate disclosure of historical financial results is not rendered misleading by failing to disclose facts which may raise questions about whether similar results will be achieved." But Bandimere made many statements about returns that were predictive rather than historic, telling investors that going forward they could expect to receive returns of 2% or 2.5% per month

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[75] *Wendy A. McNeeley, C.P.A.*, Exchange Act Release No. 68431, 2012 WL 6457291, at *9 (Dec. 13, 2012) (quoting *Aloha Airlines v. CAB*, 598 F.2d 250, 262 (D.C. Cir. 1979)).

[76] In its supplemental statement, the Division identified the individuals it claimed were defrauded, and specified when Bandimere allegedly knew the facts that the Division alleged should have been disclosed.

through IVC, and 4% per month through UCR. More importantly, there is no evidence that Bandimere disclosed accurate historical results for the investments. As discussed above, Bandimere had no visibility into the actual trading or returns at either IVC or UCR.

Finally, Bandimere claims that his omissions could not have been material because the ALJ found that he did not know, nor should he have known that the investments were Ponzi schemes. But this argument rests on a false premise: even if Bandimere was not negligent in failing to identify IVC and UCR specifically as Ponzi schemes, this does not mean that he was not aware of facts (which he failed to disclose) that called into question the legitimacy and quality of the investments. Bandimere was obliged to disclose negative facts that were known to him about the investments, which would have enabled investors to make informed decisions about investing. Therefore, we reject Bandimere's argument and find that his omissions were material.

B. Bandimere acted with scienter in offering and selling the IVC and UCR investments.

To find that Bandimere violated Exchange Act Section 10(b) and Rule 10b-5, we must find that he acted with scienter.[77] Scienter is "a mental state embracing intent to deceive, manipulate, or defraud."[78] "Scienter may be established by recklessness," which has been defined as conduct that "presents a danger of mislead-

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[77] *See Bridge*, 2009 WL 3100582, at *13 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n. 12 (1976)).

[78] *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980) (internal quotation marks omitted).

ing buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it."[79] Negligence suffices to establish liability under Securities Act Section 17(a)(2),[80] and a finding of scienter more than satisfies this requirement.[81] We find that Bandimere was reckless in making numerous and repeated statements to investors about IVC and UCR that lacked any reasonable basis and that were rendered materially misleading by his failure to disclose countervailing negative information.

Bandimere misled investors by encouraging investment in IVC and UCR, ostensibly as a neutral party, while failing to disclose the generous fees that he was

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[79] *David Henry Disraeli*, Advisers Act Release No. 2686, 2007 WL 4481515, at *5 (Dec. 21, 2007) (bracketed language in original) (quoting *SEC v. Rubera*, 350 F.3d 1084, 1094 (9th Cir. 2003), and citing additional authority). Although Bandimere argues that proof of actual intent is required to establish scienter, we have repeatedly held that recklessness is sufficient. *See, e.g.*, *Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *6 n.37 (Dec. 12, 2013) (citing *Clifton*, 2013 WL 3487076, at *10 n.67), *petition denied*, 773 F.3d 89, 94 (D.C. Cir. 2014); *Tzemach David Netzer Korem*, Exchange Act Release No. 70044, 2013 WL 3864511, at *6 n.47 (July 26, 2013) (citing *Disraeli*, 2007 WL 4481515, at *5). Bandimere asserts that the Supreme Court "has not yet accepted that recklessness satisfies the scienter standard," but the absence of a Supreme Court ruling is not an impediment to our deciding the issue.

[80] *Bridge*, 2009 WL 3100582, at *13 n.59 (citing *Aaron*, 446 U.S. at 697, 701-02); *Clifton*, 2013 WL 3487076, at *8.

[81] *See Clifton*, 2013 WL 3487076, at *10 n.67 (finding negligence analysis unnecessary for purposes of Section 17(a)(3)—which, like Section 17(a)(2), does not require scienter—where evidence established scienter).

being paid.[82] Bandimere took in fees of nearly three-quarters of a million dollars, more than half again as much as the $477,898.93 he received in "earnings" on his own investments in IVC and UCR. Since the fees were based on amounts invested (or on returns, which were themselves based on amounts invested), there was an obvious danger that Bandimere's recommendations would be influenced by his personal financial stake. Bandimere falsely telling Loebe that excess profits would go to a Christian charity rather than to pay him is also evidence of intent to deceive.[83]

Bandimere promoted IVC and UCR without a reasonable basis for the positive statements he made and while in possession of material negative information that he failed to disclose. This posed a danger of misleading investors that was so obvious that Bandimere must have been aware of it. He praised Parrish's expertise and emphasized the extent of the trad-

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[82] *See Curshen*, 372 F. App'x at 882 (finding scienter based on the "logical conclusion" that one who knew he was being compensated for promoting a stock also knew that the failure to disclose this compensation would mislead those reading his internet postings by making his opinions seem objective). *See also Gebben*, 225 F. Supp. 2d at 927 (internet poster who "knew that investors . . . would wrongly believe that his opinions represented independent research, rather than merely a recitation of what Issuers paid [his employing firm] to say" acted with scienter).

[83] Bandimere testified that he did not remember making this statement to Loebe, but the ALJ found Loebe's testimony more credible than Bandimere's as to this issue. An ALJ's credibility findings are entitled to considerable weight. *Steven Altman*, Exchange Act Release No. 63306, 2010 WL 5092725, at *4 n.10 (Nov. 10, 2010) (citing *Anthony Tricarico*, Exchange Act Release No. 32356, 1993 WL 1836786, at *3 (May 24, 1993)), *petition denied*, 666 F.3d 1322 (D.C. Cir. 2011).

ing organization he allegedly managed, with more than $20 million under management, a fifteen-year history of trading, a positive track record, and a consistent monthly return. But his positive representations about Parrish were based largely on anecdotal, second-hand information. Bandimere did not do any independent research on Parrish's trading organization and did not see any documents verifying Parrish's trading history. In addition, Bandimere knew that Parrish had been sued by the Commission, and Bandimere had even been warned by Dalton about dealing with Parrish.

Similarly, with regard to UCR, Bandimere touted Dalton's alleged high-level connections, talked about "mysterious" or "secret" people involved with the UCR programs, and emphasized the alleged safety of the investments. But these statements were based only on what Dalton had told him and were without a reasonable basis in fact. And Bandimere knew that Dalton had a long history of business failures and had reason to believe that Dalton was not keeping track himself of the amount the LLCs had invested in UCR.

Bandimere also made many statements to investors that were completely untrue. For example, with regard to UCR, Bandimere's statements to investors that the trading program involved a secret Singapore trader, that investor funds were placed in escrow and used as collateral for trading activities, and that a diamond trading program existed were all untrue statements of material fact. There was no secret trader, no funds in escrow, and no actual diamond trading because, as the court found in holding Dalton liable for his fraud, "the sole source of funds for profit payments was funds re-

ceived from other investors."[84] But Bandimere passed on these false statements without any real effort to verify them and profited handsomely for his efforts. Even if, as Bandimere claims, he did not have actual knowledge of the falsity of such statements, we find that his reckless disregard for their truth is strong evidence of his scienter.

We also find that Bandimere's failure to identify Dalton by name to Koch and Radke, while describing UCR's head as a person of significant worldwide contacts and stature, was intentionally deceptive. Bandimere knew that both Koch and Radke knew Dalton. (This is especially true with respect to Radke, since Bandimere, Radke, and Dalton all served on the board of the same local ministry.) Instead of identifying Dalton as the head of UCR, Bandimere gave a description of the unnamed head of UCR that was so at odds with the Dalton known to Koch that Koch felt "betrayed" and thought that Bandimere "had not been straight" with him once he found out that the unnamed person was actually Dalton. The record evidence supports the conclusion that Bandimere intentionally concealed Dalton's identity from Koch and Radke out of fear that they otherwise would not invest. As Koch testified, Dalton "had never . . . been successful in anything financial or in employment . . . . I just didn't see him as a person who was doing well." Radke testified that he was "not necessarily comfortable investing with Dalton."

Bandimere argues that there is no evidence that he knew or believed that Koch or Radke would have

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[84] *Universal Consulting Res., LLC*, 2011 WL 6012536, at *2.

viewed Dalton's involvement negatively. We disagree. We find that Bandimere's own knowledge of Dalton's questionable financial background, and the fact that he stressed his personal relationship with Dalton in his discussions with other investors provides ample circumstantial evidence to support our finding that Bandimere suspected that knowledge of Dalton's involvement in UCR could deter Koch and Radke from investing.[85]

Bandimere argues that the undisputed fact that he had thousands of dollars of his own money invested in IVC and UCR when he was discussing those investments with others is evidence that he did not act with fraudulent intent. But by far the biggest part of his income from IVC and UCR was the hundreds of thousands of dollars he earned by getting others to invest. It was at least reckless that Bandimere did not reveal material negative information in his possession while using positive representations in order to solicit investments that directly benefited him financially—even if he was ignorant of the fraudulent nature of the investments.

Bandimere argues, citing *South Cherry Street LLC v. Hennessee Group*,[86] that where recklessness is alleged to be failing to recognize the fraud of others, that recklessness must approximate an actual intent to aid

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[85] Bandimere's reliance on *NLRB v. Martin A. Gleason, Inc.*, 534 F.2d 466, 474 (2d Cir. 1976), is misplaced. That case holds that findings of fact must be based on reasonable inferences, and here it is perfectly reasonable to infer from the evidence in the record that Bandimere believed mentioning Dalton's involvement to Koch and Radke would make them less likely to invest.

[86] 573 F.3d 98, 109-10 (2d Cir. 2009).

in the fraud. But the basis for the charges of fraud against Bandimere was not that he failed to recognize others' fraud, but rather that he failed to disclose material negative facts in his possession that would have let investors make informed decisions. Thus, Bandimere's reliance on *South Cherry Street* is misplaced. Our finding of scienter is entirely consistent with the standard applied by the court in *South Cherry Street*.[87]

Similar to the argument he raised about the OIP providing insufficient notice of his fraudulent statements and omissions, Bandimere contends that he "had no notice that the facts found to prove scienter would be at issue." For the same reasons we rejected the earlier argument, we reject this one: there is no requirement for the OIP to allege all of the particular facts upon which an element of a violation may be founded.[88] The requirements of Rule 200(b) are satisfied here and the ALJ did not exceed his authority.[89]

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[87] *Compare supra* text accompanying note 79 (quoting recklessness standard used in *Disraeli*, 2007 WL 4481515, at *5), with *South Cherry Street*, 573 F.3d at 109 (quoting standard from *In re Carter-Wallace, Inc. Sec. Litig.*, 220 F.3d 36, 39 (2d Cir. 2000)).

[88] *See supra* note 74 and accompanying text.

[89] Contrary to Bandimere's insistence, his accepting Pickering's $100,000 investment in the UCR diamond program in March 2010, following a warning from Syke about further investments, is within the scope of the OIP. *See* OIP ¶¶ 1, 2, 29. Nevertheless, unlike the ALJ, we do not rely on Bandimere's conduct with regard to Pickering's March 2010 diamond program investment in our finding of scienter. In addition, unlike the ALJ, we do not base our finding of scienter on Bandimere's alleged "bullying" of Koch. There is ample evidence of scienter without relying on these episodes.

For the above reasons, we find that Bandimere violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV. CONSTITUTIONAL CHALLENGES

A. Equal-Protection Defense

Bandimere argues that he was denied equal protection because the Commission proceeded against him administratively rather than in federal district court. The thrust of his equal-protection argument is that the Commission "sues Ponzi schemers in federal courts," but that his case, which he contends "alleg[es] he must have known he was getting investors involved in a Ponzi scheme," was brought as an administrative proceeding. He argues that he was "singled out and denied the opportunity for a trial by jury, presided over by an Article III judge, and denied discovery under the Federal Rules of Civil Procedure" and that this denial "impaired his ability to mount a full defense." We reject Bandimere's equal-protection defense for several reasons.

First, an equal-protection claim is not legally cognizable in the context of an inherently discretionary governmental decision to bring charges in one forum rather than another. The Supreme Court held in *Village of Willowbrook v. Olech* that an individual who is not a member of a protected class may in some contexts assert a "class-of-one" equal-protection claim by establishing that he or she was "intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treat-

ment."[90] But the Supreme Court has subsequently made clear that *Olech*, which involved a landowner's challenge to a zoning decision, does not apply to every kind of government action. There are, the Court explained, "some forms of state action . . . which by their nature involve discretionary decisionmaking based on a vast array of subjective, individualized assessments."[91] In such contexts, a "'class-of-one' theory of equal protection has no place" because "allowing a challenge based on the arbitrary singling out of a particular person would undermine the very discretion that such state officials are entrusted to exercise."[92] The Commission's choice to bring an action in an administrative forum is a decision committed to agency discretion.[93]

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[90] 528 U.S. 562, 564 (2000).

[91] *Engquist v. Oregon Dept. of Ag.*, 553 U.S. 591, 592, 603 (2008).

[92] *Id.* at 603.

[93] *See* 17 C.F.R. § 202.5(b) ("After investigation or otherwise the Commission may in its discretion take one or more of the following actions: Institution of administrative proceedings looking to the imposition of remedial sanction, initiation of injunctive proceedings in the courts, and, in the case of a willful violation, reference of the matter to the Department of Justice for criminal prosecution."); *Robert Radano,* Investment Advisors Act Release No. 2750, 2008 WL 2574440, at *8 n. 74 (June 30, 2008) (determination whether to proceed against some rather than others is committed to agency discretion); *Eagletech Commc'ns, Inc.*, Exchange Act Release No. 54095, 2006 WL 1835958, at *4 (July 5, 2006) (same). In the analogous context of federal prosecutors' decisions about charging defendants, courts have rejected class-of-one claims based on prosecutorial discretion. *See, e.g.*, *United States v. Moore*, 543 F.3d 891, 901 (7th Cir. 2008) (holding that "the discretion conferred on prosecutors in choosing whom and how to prosecute" precludes a class-of-one equal-protection claim in that context); *United States v. Green*, 654 F.3d 637, 650 (6th Cir. 2011) (rejecting

Accordingly, Bandimere's class-of-one equal- protection challenge must fail.

Second, even if a class-of-one equal-protection claim were cognizable in this context, Bandimere has failed to make the requisite threshold showing that he was "treated differently from others similarly situated."[94] Individuals asserting such a claim "must show an extremely high degree of similarity between themselves and the persons to whom they compare themselves."[95] But Bandimere has merely pointed to the fact that most "alleged Ponzi schemers" in recent years have been subject to civil injunctive actions. He has not compared the facts and circumstances of those cases with his own to any degree of detail, much less shown that his case bears such an "extremely high degree of similarity" to those cases that he must have been "singled out." To the contrary, Bandimere acknowledges that a dozen other cases have in fact been brought against Ponzi schemers administratively, as was done here. While conceding this fact, Bandimere attempts to distinguish the administrative proceedings brought against Ponzi schemers, asserting that they were settled, involved licensed securities professionals, or did not al-

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a class-of-one claim premised on "government's decision to prosecute [the defendant] under MEJA in the civilian justice system while prosecuting his coconspirators under UCMJ in the military justice system").

[94] *Olech*, 528 U.S. at 564.

[95] *Clubside, Inc. v. Valentin*, 468 F.3d 144, 159 (2d Cir. 2006); *see also Cordi-Allen v. Conlon*, 494 F.3d 245, 250-51 (1st Cir. 2007) (explaining that the requirement of establishing a "extremely high degree of similarity" includes demonstrating the absence of any "distinguishing or mitigating circumstances as would render the comparison inutile").

lege that the respondents knowingly involved investors in a fraudulent scheme. But the fact that some of these cases may differ in some respects does not establish that Bandimere has been singled out. Bandimere has failed to "identify and relate specific instances where persons situated *similarly* in all relevant aspects were treated differently" from him.[96] Moreover, Bandimere was not charged with perpetrating a Ponzi scheme in the first place, so the idea that he was "singled out" from a group he does not belong to makes no sense. For these reasons, his equal-protection claim must fail.

Finally, contrary to Bandimere's contention, there was a "benign reason to proceed against Mr. Bandimere administratively." Thus, he has also failed to establish that "there is no rational basis for the [alleged] difference in treatment," even if any such difference exists.[97] Bandimere was alleged to have been, and we have found that he was, acting as an unregistered broker. This provided a jurisdictional basis for the remedy the Division sought, and that we have imposed, of an associational bar for the protection of investors in the public interest—a statutory remedy that Congress made available to the Commission in administrative proceedings. That Bandimere was acting as a broker without being a licensed securities professional in no way diminishes the appropriateness of seeking such a

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[96] *Cordi-Allen*, 494 F.3d at 251 (emphasis added).

[97] *Olech*, 528 U.S. at 564; *cf. Campbell v. Rainbow City*, 434 F.3d 1306, 1314 n.6 (11th Cir. 2006) (requiring plaintiff asserting rational-basis challenge to "negativ[e] every conceivable basis which might support the government action") (quotation marks omitted).

remedy. The statute does not distinguish, nor should it, between registered and non-registered brokers.[98]

For all of the above reasons, we reject Bandimere's equal-protection defense.

B. Appointments Clause Challenge

Bandimere argues that ALJ Cameron Elliot—who presided over this matter and issued the Initial Decision—was not appointed in a manner consistent with the Appointments Clause of the Constitution. We find that the appointment of Commission ALJs is not subject to the requirements of the Appointments Clause.

Under the Appointments Clause, certain high-level government officials must be appointed in particular ways: "Principal officers" must be appointed by the President (and confirmed by the Senate), while "inferior officers" must be appointed either by the President, the heads of departments, or the courts of law.[99] The great majority of government personnel are neither principal nor inferior officers, but rather "mere employees" whose appointments are not restricted by the Appointments Clause.[100] It is undisputed that ALJ Elliot was not appointed by the President, the head of a

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[98] *See infra* note 156 and accompanying text.

[99] The Clause provides that the President "by and with the advice and consent of the Senate, shall appoint . . . officers of the United States . . . but the Congress may by law vest the appointment of such inferior officers, as they think proper, in the President alone, in the courts of law, or in the heads of departments." U.S. Const. art. II, §2, cl. 2.

[100] *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C. Cir. 2000) (quoting *Freytag v. Commissioner*, 501 U.S. 868, 882 (1991)); *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

department, or a court of law.[101] Bandimere therefore contends that his appointment violates the Appointments Clause because, in his view, ALJ Elliot should be deemed an inferior officer. The Division counters that he is an employee and thus there was no violation of the Appointments Clause.

As we have recently explained,[102] the D.C. Circuit's decision in *Landry v. FDIC* generally controls our resolution of this question.[103] *Landry* held that, for purposes of the Appointments Clause, ALJs at the Federal Deposit Insurance Corporation ("FDIC"), who oversee administrative proceedings to remove bank executives, are employees rather than inferior officers. *Landry* explained that the touchstone for determining whether adjudicators are inferior officers is the extent to which they have the power to issue "final decisions."[104] Although ALJs at the FDIC take testimony, conduct trial-like hearings, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders, they "can never render the decision of the FDIC."[105] Instead, they issue only "recommended decisions" which the FDIC Board of Directors reviews de novo, and "[f]inal decisions are issued

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[101] The Commission constitutes the "head of a department" when its commissioners act collectively. *See Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010).

[102] *In the Matter of Raymond J. Lucia Companies*, Exchange Act Release No. 34-75837, 2015 WL 5172953, at *21-23 (Sept. 3, 2015); *In the Matter of Timbervest, LLC*, Investment Advisers Act Release No. 4197, 2015 WL 5472520, at *23-*26 (Sept. 17, 2015).

[103] 204 F.3d 1125 (D.C. Cir. 2000).

[104] *Id.* at 1133-34.

[105] *Id.* at 1133.

only by the FDIC Board."[106] The FDIC ALJs thus function as aides who assist the Board in its duties, not officers who exercise significant authority independent of the Board's supervision. Because ALJs at the FDIC "have no such powers" of "final decision," the D.C. Circuit "conclude[d] that they are not inferior officers."[107]

The mix of duties and powers of the Commission's ALJs are very similar to those of the ALJs at the FDIC. Like the FDIC's ALJs, the Commission's ALJs conduct hearings, take testimony, rule on admissibility of evidence, and issue subpoenas. And like the FDIC's ALJs, the Commission's ALJs do not issue the final decisions that result from such proceedings. Just as the FDIC's ALJs issue only "recommended decisions" that are not final, the Commission's ALJs issue "initial decisions" that are likewise not final.[108] Respondents may petition the Commission for review of an ALJ's initial decision,[109] and it is our "longstanding practice [to] grant[] virtually all petitions for review."[110] In-

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[106] *Id.*

[107] *Id.* at 1134.

[108] *See* 17 CFR 201.360(a)(1) & (d).

[109] 17 CFR 201.411(b).

[110] Exchange Act Release No. 35833, 1995 WL 368865, at *80-81 (June 9, 1995); *see also* Exchange Act Release No. 33163, 1993 WL 468594, at *55-59 (Nov. 5, 1993) (explaining that we are "unaware of any case in which the Commission has declined to grant a petition for review"). We reiterated this policy in the context of amendments to our Rules of Practice in 2004 that eliminated the filing of oppositions to petitions for review. We deemed such oppositions pointless, "given that the Commission has long had a policy of granting petitions for review, believing that there is a benefit to Commission review when a party takes exception to a decision."

deed, we are unaware of any case in which the Commission has not granted a petition for review. Absent a petition, we may also choose to review a decision on our own initiative.[111] In either case, our rules expressly provide that "the initial decision [of an ALJ] shall not become final."[112] Even where an aggrieved person fails to file a timely petition for review of an initial decision and we do not order review on our own initiative, our rules provide that "*the Commission* will issue an order that the decision has become final," and it becomes final only "upon issuance of the order" by the Commission.[113] Moreover, as does the FDIC, the Commission reviews our ALJs' decisions de novo.[114]

Exchange Act Release No. 48832, 2003 WL 22827684, at *13 (Nov. 23, 2003).

[111] 17 CFR 201.411(c); *see also* 15 U.S.C. 78d-1(b) (providing that "the Commission shall retain a discretionary right to review the action of any . . . administrative law judge . . . upon its own initiative or upon petition").

[112] 17 CFR 201.360(d)(1).

[113] 17 CFR 201.360(d)(2) (emphasis added). An initial decision does *not* become final simply "on the lapse of time" for seeking review. Exchange Act Release No. 49412, 2004 WL 503739, at *12 (Mar. 12, 2004).

[114] We do not view the fact that we accord Commission ALJs deference in the context of demeanor-based credibility determinations to afford our ALJs with the type of authority that would qualify them as inferior officers. First, as we have repeatedly made clear, we do not accept such findings "blindly," and we will "disregard explicit determinations of credibility" when our de novo review of the record as a whole convinces us that a witness's testimony is credible (or not) or that the weight of the evidence warrants a different finding as to the ultimate facts at issue. *Id.* at *10; *accord Francis V. Lorenzo*, Exchange Act Release No. 74836, 2015 WL 1927763, at *10 n.32 (Apr. 29, 2015); *Irfan Mohammed Amanat*, Exchange Act Release No. 54708, 2006 WL 3199181, at *8 n.46

Upon review, we "may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part," any initial decision.[115] And "any procedural errors" made by an ALJ in conducting the hearing "are cured" by our "thorough, *de novo* review of the record."[116] We may expand the record by "hear[ing] additional evidence" ourselves or remanding for further proceedings before the ALJ, and may "make any findings or conclusions that in [our] judgment are proper and on the basis of the record."[117]

Bandimere suggests that our ALJs enjoy as much discretion as Article III trial judges. But that is not the case. A trial judge's factual findings are afforded significant deference by reviewing courts, while findings made by our ALJs are not. And although ALJs

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(Nov. 3, 2006); *see also Kay v. FCC*, 396 F.3d 1184, 1189 (D.C. Cir. 2005) ("The law is settled that an agency is not required to adopt the credibility determinations of an administrative law judge."). Second, our practice in this regard is no different from the FDIC's and so does not warrant a departure from *Landry*. *Compare [Redacted] Insured State Nonmember Bank*, FDIC-82-73a, 1984 WL 273918, at *5 (June 18, 1984) (stating, "as a general rule," that "the assessment of the credibility of witnesses" by the ALJ is given "deference" by the FDIC) *with Ramon M. Candelaria*, FDIC-95-62e, 1997 WL 211341, at *3-4 (Mar. 11, 1997) (noting that the FDIC ALJ found respondent to be "entirely credible" but rejecting respondent's testimony "in light of the entire record").

[115] 17 CFR 201.411(a); *see also* 5 U.S.C. 557(b) ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision . . . .").

[116] *Heath v. SEC*, 586 F.3d 122, 142 (2d Cir. 2009); *see also, e.g.*, *Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, at *20 (Feb. 20, 2015) ("[O]ur *de novo* review cures any evidentiary error that the law judge may have made.").

[117] 17 CFR 201.411(a); 17 CFR 201.452.

may oversee the taking and hearing of evidence, we have made clear that we have "plenary authority over the course of [our] administrative proceedings and the rulings of [our] law judges—both before and after the issuance of the initial decision and irrespective of whether any party has sought relief."[118] This includes authority over all evidentiary and discovery-related rulings. We are not limited by the record that comes to us. As explained above, we may expand the record. The fact that our ALJs may rule on evidentiary matters and discovery issues (subject to our de novo review) does not distinguish them from the FDIC's ALJs in *Landry* who have the same authority.

Bandimere also objects to "the *Landry* court's reading" of a Supreme Court decision, *Freytag v. Commissioner*,[119] which held that a "special trial judge" of the Tax Court was an inferior officer. Bandimere suggests that *Landry* was wrong to distinguish *Freytag*. But we agree with *Landry*'s analysis and the distinctions it identifies between ALJs and the special trial judges at issue in *Freytag*. As *Landry* recognized, ALJs are different from the special trial judges at issue in *Freytag*.[120] The greater role and powers of the special trial judges relative to Commission ALJs, in our view, makes *Freytag* inapposite here. First, unlike the ALJs whose decisions are reviewed de novo, the special trial judges made factual findings to which the Tax Court

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[118] *Michael Lee Mendenhall*, Release No. 4051 (March 19, 2015), 2015 WL 1247374, at *1.

[119] 501 U.S. 868 (1991).

[120] *Landry*, 204 F.3d at 1133 (explaining that the special trial judges at issue in *Freytag* exercised "authority . . . not matched by the ALJs").

was required to defer, unless clearly erroneous.[121] Second, the special trial judges were authorized by statute to "render the [final] decisions of the Tax Court" in significant, fully-litigated proceedings involving declaratory judgments and amounts in controversy below $10,000.[122] As discussed above, our ALJs issue initial decisions that are not final unless the Commission takes some further action. Third, the Tax Court (and by extension the court's special tax judges) exercised "a portion of the judicial power of the United States," including the "authority to punish contempts by fine or imprisonment."[123] Commission ALJs, by contrast, do not possess such authority.[124] And while Commission ALJs may issue subpoenas to compel noncompliance, they are powerless to enforce their subpoenas; the

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[121] *See id.*

[122] *Freytag*, 501 U.S. at 882.

[123] *Id.* at 891.

[124] *See* 17 CFR 201.180. The Commission's rules provide ALJs with authority to punish contemptuous conduct only in the following ways. If a person engages in contemptuous conduct before the ALJ during any proceeding, the ALJ may "exclude that person from such hearing or conference, or any portion thereof," or "summarily suspend that person from representing others in the proceeding in which such conduct occurred for the duration, or any portion, of the proceeding." *Id.* 201.180(a). If there are deficiencies in a filing, a Commission ALJ "may reject, in whole or in part," the filing, such filing "shall not be part of the record," and the ALJ "may direct a party to cure any deficiencies." *Id.* 201.180(b). Finally, if a party fails to make a required filing or to cure a deficiency with a filing, then a Commission ALJ "may enter a default, dismiss the case, decide the particular matter at issue against the person, or prohibit the introduction of evidence or exclude testimony concerning that matter." *Id.* 201.180(c). Any such ruling would, of course, be subject to de novo Commission review.

Commission itself would need to seek an order from a federal district court to compel compliance.[125] In this respect, too, our ALJs are akin to the FDIC's ALJs that *Landry* found to be "mere employees."[126]

Based on the foregoing, we conclude that the mix of duties and powers of our ALJs is similar in all material respects to the duties and role of the FDIC's ALJs in *Landry*.[127] Accordingly, we follow *Landry*, and we conclude that our ALJs are not "inferior officers" under the Appointments Clause.[128]

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[125] *See* 15 U.S.C. § 78u(c).

[126] *See* 12 CFR 308.25(h), 308.26(c), 308.34(c) (providing that an aggrieved party must apply to a federal district court for enforcement of a subpoena issued by a FDIC ALJ).

[127] We do not find any relevance in the fact that the federal securities laws and our regulations at times refer to ALJs as "officers" or "hearing officers." There is no indication that Congress intended "officers" or "hearing officers" to be synonymous with "Officers of the United States," U.S. Const. art. II, § 2, cl. 2, and the word "officer" in our regulations has no such meaning. We also note in this regard that the Administrative Procedure Act "consistently uses the term 'officer' or the term 'officer, employee, or agent'" to "refer to [agency] staff members." Kenneth Culp Davis, *Separation of Functions in Administrative Agencies,* 61 HARV. L. REV. 612, 615 & n.11 (1948). *Cf.* 5 U.S.C. §§ 556, 557 (referring to official who presides over evidentiary hearing as the "presiding employee").

[128] Beyond *Landry*, we believe that our ALJs are properly deemed employees (rather than inferior officers) because this is how Congress has chosen to classify them, and that decision is entitled to considerable deference. *See Burnap v. United States*, 252 U.S. 512, 516 (1920). For example, as we discussed above, Congress created and placed ALJ positions within the competitive service system, just like most other federal employees. Like such other employees, an ALJ who believes that his employing agency

V. EVIDENTIARY ISSUES

Before the hearing in this matter, Bandimere asked the ALJ to issue a subpoena directed to the Commission for the production of various documents: (1) items related to a prior investigation and enforcement action against Parrish;[129] (2) parts of documents that had been withheld as attorney work product, including interview notes and memoranda; (3) training materials used by the Commission relating to facts or circumstances that may indicate the existence of a Ponzi scheme; and (4) portions of documents relating to the decision to institute an administrative proceeding rather than a civil enforcement action against Bandimere. The Division opposed Bandimere's request, and the ALJ denied it. Bandimere challenges the ALJ's decision as arbitrary and capricious.[130] Under Rule 232(b) of our Rules of Practice, the person to whom a request for a subpoena is directed may refuse to issue the subpoena if the subpoena or any of its terms is unreasonable, oppressive, excessive in scope, or unduly burdensome.[131]

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has engaged in a prohibited personnel practice can seek redress either through the Office of Special Counsel or the Merit Systems Protection Board. *See* 5 U.S.C. §§ 1204, 1212, 1214, 1215, 1221. And ALJs—like other employees—are subject to reductions-in-force. *See id.* § 7521(b).

[129] *See supra* note 67 (providing background about *SEC v. Z-Par Holdings, Inc.*).

[130] The parties and the ALJ refer to the ALJ's action as quashing the subpoena, but since the subpoena was not issued, there was nothing to quash. Bandimere also requested documents the Division had received from other federal agencies; he does not seek review of this aspect of the ALJ's denial.

[131] 17 C.F.R. § 201.232(b).

We agree with the ALJ's denial, pursuant to Rule 232, of Bandimere's request.[132]

First, Bandimere failed to show that any of the documents he requested in relation to Parrish's prior involvement with a Ponzi scheme other than IVC had any relevance to Bandimere's alleged violations in this case. Bandimere's request was thus excessive in scope, and requiring the Division to produce those documents would have been unreasonable.

Second, Bandimere's request for factual portions of documents withheld as attorney work product was excessive in scope. Rule 230(b) permits the Division to withhold internal memoranda, notes, or writings prepared by Commission employees as well as attorney work product. The privilege protecting factual portions of work product may be overcome on a showing that the person seeking the materials has a substantial need for them and no way of obtaining their substantial equivalent without undue hardship.[133] Bandimere has

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[132] Bandimere argues, citing an order issued by the ALJ in *Hector Gallardo*, Administrative Proceedings Rulings Release No. 667 (Feb. 25 2011), *available at* http://www.sec.gov/alj/aljorders/2011, that a party seeking to quash a subpoena cannot show that the subpoena is unreasonable, oppressive, or unduly burdensome within the meaning of Rule of Practice 232(e)(2) merely by contending that the subpoena seeks information that is not relevant, nor reasonably likely to lead to the discovery of relevant evidence. In this case the Division made particularized arguments as to why the ALJ should not require it to produce the documents Bandimere requested. Because the ALJ acted in accordance with Rule 232 in refusing to issue the subpoena, we find no basis to disturb his decision.

[133] *See United States ex rel. Stone v. Rockwell Int'l Corp.*, 144 F.R.D. 396, 401 (D. Colo. 1992) ("[F]actual work product . . .

not made such a showing, but instead asserts that materials withheld by the Division might be the only source of information with respect to certain issues. In addition to turning over the contents of its investigative file,[134] the Division, pursuant to Rule 230(b), gave Bandimere a list of possible material exculpatory evidence from withheld documents. This list contained summaries of statements made by investors, including two of the investors who testified at the hearing, Hunter and Moravec. The Division also submitted a declaration by its trial counsel in this matter describing the Division's review of documents in its withheld document list and representing that all identified possible material exculpatory evidence was included in the list it provided. Under these circumstances, we find no error in the ALJ's decision to refuse to issue the subpoena for the factual portions of the work product documents.[135]

Bandimere argues that the ALJ's order in *Thomas R. Delaney II*[136] supports his argument that the Division did not adequately establish that certain documents were protected by the work product privilege.

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is discoverable upon a showing that (a) the party seeking discovery has substantial need of the materials in the preparation of his case; and (b) he is unable without undue hardship to obtain the substantial equivalent of the materials by other means." (citation omitted)).

[134] The Division represented that it turned over nearly 3 GB of data, encompassing over 11,000 files.

[135] *See, e.g., optionsXpress, Inc.*, Exchange Act Release No. 70698, 2013 WL 5635987, at * 6-8 (Oct. 16, 2013) (refusing to order Division to turn over internal work product where Division had already provided extensive discovery and had explicitly represented that it had turned over all Brady material).

[136] Administrative Proceedings Rulings Release No. 1652 (July 25, 2014), *available at* http://www.sec.gov/alj/aljorders/2014/ap-1652.pdf.

The ALJ in *Delaney* found that correspondence between the Division and the respondent did not establish that the work product privilege protected certain documents, and she ordered the Division to submit a more detailed privilege log for her review. In contrast, before making his decision on the subpoena in this proceeding the ALJ had already received a withheld document list from the Division; he found the list "generally acceptable," and asked for a more detailed log only with respect to one category of documents.[137] The ALJ's decision in *Delaney* requiring more detailed substantiation does not establish that the ALJ in this proceeding should have acted differently.[138]

Third, Bandimere's request for training materials related to Ponzi schemes was also appropriately denied. Bandimere was not charged with having failed to recognize that IVC and UCR were Ponzi schemes. He was charged with failing to disclose material facts that reasonable investors would have wanted to consider in making investment decisions. Thus, the training materials were irrelevant to the issue with respect to which Bandimere sought them.

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[137] The Division subsequently turned over the documents originally withheld in this category to Bandimere, thus mooting the need to submit a detailed log.

[138] ALJs' rulings are not precedential and are not binding on the Commission or on other ALJs. *See, e.g.*, *Sands Bros. Asset Mgmt.*, Advisers Act Release No. 4083, 2015 WL 2229281, at *4 (May 13, 2015); *John Thomas Capital Mgmt. Group LLC*, |Exchange Act Release No. 74345, 2015 WL 728006, at *3 & n.20 (Feb. 20, 2015); *Absolute Potential, Inc.*, Exchange Act Release No. 71866, 2014 WL 1338256, at *8 n.48 (Apr. 4, 2014).

Finally, Bandimere was not entitled to the factual portions of documents related to the Commission's decision to proceed against him administratively, and we also deny his motion filed during the pendency of this appeal for a copy of the action memorandum submitted to the Commission before we issued the OIP in this matter. Before the ALJ and again before us, he argues that his interest in these materials "extends only as far as it may be relevant to his [equal protection] defense," i.e., that the Commission improperly singled him out by differentiating him from other respondents alleged to have engaged in Ponzi schemes by proceeding against him administratively. As we have previously stated, Bandimere's assertion that he was treated differently from other respondents is incorrect on several levels.[139] Thus, Bandimere has not shown that the action memorandum is relevant to the issue with regard to which he seeks it—establishing the equal-protection defense he asserts.

Moreover, as the Division has consistently maintained, the action memo is protected from disclosure by multiple evidentiary privileges.[140] Bandimere argues that the Division waived any applicable privilege related to the action memorandum by citing, in its response to Bandimere's opening brief, the ALJ's state-

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[139] *See supra* Section IV.A.

[140] Documents considered by the Commission in deciding whether and how to proceed against Bandimere are protected by the deliberative process privilege. *See Fox News Network LLC v. U.S. Dep't of the Treasury*, 739 F. Supp. 2d 515, 541 (S.D.N.Y. 2010) (stating that the deliberative process privilege "applies to materials that are part and parcel of the process of internal agency decision making" (citing *NLRB v. Sears, Roebuck & Co.*, 421 U.S. 132, 150 (1975)).

ment that he had determined after in camera review that the contents of the memorandum were not helpful to Bandimere. Bandimere raised essentially the same argument before the ALJ—contending that the Division's citation in in its post-hearing brief to the ALJ's statement effected a waiver of privilege. We reject Bandimere's waiver argument. The Division did not waive its claim that the action memorandum was privileged when it referred to the ALJ's statement. The Division neither cited the action memorandum nor offered it as evidence. Merely alluding to the ALJ's statement did not waive the privilege with respect to the underlying document.[141] Accordingly, we deny Bandimere's request for the action memorandum to be turned over to him.[142]

VI. SANCTIONS

The ALJ barred Bandimere from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; ordered Bandimere to cease and desist from committing or causing violations of Securities Act Section 5(a), 5(c), and 17(a), Exchange Act Sections 10(b) and 15(a), and Exchange Act Rule 10b-5; ordered Bandimere to disgorge $638,056.33 plus prejudgment interest; and imposed a third-tier civil penalty of $390,000. As dis-

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[141] We note that the ALJ's statement played no role in our analysis of Bandimere's equal-protection defense, which we have rejected for the reasons set forth above.

[142] Because we do not order that Bandimere be given a copy of the action memorandum, we deny his motions that it be made part of the record and that he be permitted to file a supplemental brief based on its contents.

cussed below, based on our consideration of the relevant factors, we impose the same sanctions as the ALJ, except that we will not bar Bandimere from association with a municipal advisor or a nationally recognized statistical rating organization.[143]

A. Bar

Exchange Act Section 15(b)(6)(A) authorizes us to bar any person who, at the time of the misconduct, was associated with a broker or dealer, from "being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization" if we find "on the record after notice and opportunity for a hearing" that the person willfully violated the securities laws and the sanction is in the public interest.[144] In imposing an industry-wide bar, the ALJ included bars from associating with any nationally recognized statistical rating organization or municipal advisor based on the expanded relief authorized by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Because the conduct at issue here occurred before Dodd-Frank authorized complete industry bars, consistent with the D.C. Circuit's recent decision in *Koch v. SEC*,[145] we conclude that it is appropriate to modify the bar imposed by the ALJ to the extent that it bars Bandimere from associ-

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[143] Pursuant to Rule of Practice 411(d), 17 C.F.R. § 201.411(d), we determined on our own initiative to review what sanctions, if any, are appropriate in this matter.

[144] 15 U.S.C. § 78*o*(b)(6)(A).

[145] 793 F.3d 147, 157-59 (D.C. Cir. 2015) (holding that municipal advisor and rating organization bars were retroactively applied to respondent for pre Dodd-Frank conduct).

ating with any nationally recognized statistical rating organization or municipal advisor but to maintain it in all other respects. Accordingly, we have determined to bar Bandimere from associating with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent.

1. Barring Bandimere is statutorily authorized.

Bandimere argues that Section 15(b) does not apply to him because he was neither a registered broker or dealer nor associated with a registered broker or dealer. But Section 15(b) does not limit us to proceeding administratively against registered brokers or dealers and their associated persons.[146] We have previously determined that we have authority under Section 15(b)(6) to discipline associated persons of unregistered broker-dealers,[147] and we have used that authority to impose a bar on an associated person of an unregistered broker.[148] Bandimere's status as an unregistered broker is therefore no impediment to our action here.

Bandimere further argues that, by its terms, Section 15(b)(6) applies only to a person associated with a

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[146] *See First Jersey Securities, Inc.*, Exchange Act Release No. 37259, 1996 WL 290276, at *2 n.7 (May 30, 1996); *John Kilpatrick*, Exchange Act Release No. 23251, 1986 WL 626187, at *4-5 (May 19, 1986); s*ee also* text accompanying note 156 *infra* (noting that Section 15(b) does not distinguish between registered and non-registered brokers and dealers).

[147] *See Victor Teicher*, Exchange Act Release No. 40010, 1998 WL 251823, at *3 (May 20, 1998), *affirmed in part and reversed in part*, 177 F.3d 1016 (D.C. Cir. 1999).

[148] *See Vladislav Steven Zubkis*, Exchange Act Release No. 52876, 2005 WL 3299148 (Dec. 2, 2005), *reconsideration denied*, Exchange Act Release No. 52876, 2006 WL 985310 (Apr. 13, 2006).

broker or dealer, or who was seeking to become associated, or who was participating in a penny stock offering. He asserts that there was no allegation, nor any evidence, that he fit within any of these categories, and that therefore Section 15(b)(6) provides no authority to sanction him.

Bandimere misconstrues the statutory requirement. Under Section 3(a)(18) of the Exchange Act, "person associated with a broker or dealer" is broadly defined to include "any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer."[149] As discussed previously, we have found that Bandimere himself meets the definition of a broker under the Exchange Act.[150] We also find that he qualifies as a "person associated with a broker" and comes within the reach of Section 15(b)(6) because he directly controls his own actions as a broker. To hold otherwise would prevent the Commission from barring natural persons who themselves meet the definition of a broker but who are not otherwise associated with a broker—something that would be inconsistent with the Exchange Act's purpose of protecting investors. We therefore con-

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[149] 15 U.S.C. § 78c(a)(18). Persons associated with a broker or dealer whose functions are solely clerical or ministerial are generally not included in the meaning of the term "person associated with a broker or dealer" for purposes of Exchange Act Section 15, but they, too, are subject to Section 15(b)(6). *Id.*

[150] *See supra* Section II.B.2.a.

clude that Bandimere may be barred under Section 15(b)(6).

2. Bandimere's violations of the securities laws were willful.

As noted, Exchange Act Section 15(b) authorizes us to bar individuals for willful violations of the securities laws. In this context, willfulness is shown where a person intends to commit an act that constitutes a violation; there is no requirement that the actor also be aware that he is violating any statutes or regulations.[151] Bandimere does not contend that he did not know that he was committing the acts involved in offering and selling the interests in IVC and UCR. On the record before us, we find that he acted willfully.

Bandimere argues that the standard the ALJ used to determine willfulness—whether the person charged knows what he or she was doing—was not the proper standard and that under a proper standard the Division has failed to prove that his violations of Securities Act Section 5 and Exchange Act Section 15(a) were willful. But the standard the ALJ applied has been firmly established in our cases, as well as in federal court decisions, for half a century. In its 2000 opinion in *Wonsover v. SEC*, the United States Court of Appeals for the District of Columbia Circuit called it "our traditional formulation of willfulness for the purpose of [Exchange Act Section] 15(b)."[152] The court quoted its

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[151] *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

[152] *Id.* at 415. Bandimere contends that *Wonsover* did not "confirm the meaning of willful," or endorse the standard used by the ALJ in this proceeding, but rather held that the meaning of "willful" was unresolved. This is a misreading of the case. Although

1965 statement in *Gearhart & Otis, Inc. v. SEC*, "'[I]t has been uniformly held that "willfully" in this context means intentionally committing the act which constitutes the violation.'"[153] *Gearhart & Otis*, in turn, cited *Tager v. SEC*, a 1965 opinion of the United States Court of Appeals for the Second Circuit, as the source of the quoted language.[154] Thus, as early as 1965, two different federal courts of appeals identified this interpretation of "willful" for purposes of Section 15(b) as "uniformly held." Bandimere has not identified any other standard used to determine willfulness in proceedings brought under Exchange Act Section 15(b). Although Bandimere argues that Congress must have intended a qualitative distinction between violations that are willful and those that are not, he points to no authority supporting his argument that willfulness, as applied to a violation under Section 15(b), means more than the standard articulated in *Wonsover*, and there is abundant authority to the contrary.[155]

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the court held that Wonsover's violations were willful under either the court's traditional formulation "or even under the subjective recklessness standard" that Wonsover pressed, there is nothing in the court's decision to support Bandimere's contention that the court regarded the question as unresolved, and it did nothing to back away from what it recognized was the "uniformly held" standard. *See id.* at 414-15.

[153] *Id.* at 414 (quoting *Gearhart & Otis*, 348 F.2d 798, 803 (D.C. Cir. 1965).

[154] *Gearhart & Otis*, 348 F.2d at 803 (quoting *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965)).

[155] *See, e.g.*, *Mathis v. SEC*, 671 F.3d 210, 217-18 (2d Cir. 2012) (reaffirming *Tager*'s standard for willfulness—that "willfully" means "intentionally committing the act which constitutes the violation"—in the context of Exchange Act Section 15(b) and a related statu-

Bandimere further argues that unlike Wonsover he is not a licensed professional and that with respect to an unlicensed person willfulness requires at least negligence. But Section 15(b) speaks of willful conduct by persons associated with "*any* broker or dealer," making no distinction between registered and non-registered brokers and dealers.[156] And Congress's decision to make no such distinction makes sense: the effect of a broker's conduct on the investing public is the same whether he is registered or not, and allowing greater

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tory provision); *Nees v. SEC*, 414 F.2d 211, 221 (9th Cir. 1969) (holding that "willfulness" in the context of Section 15(b) "means only that the act was a conscious, intentional action" and that the petitioner's conduct in violation of Securities Act Section 5 "[c]learly . . . fall[s] within this definition of 'willfulness'"); *Capital Funds, Inc. v. SEC*, 348 F.2d 582, 588 (8th Cir. 1965) (holding in the context of Section 15(b) "willfulness means only the intentional commission of the act, no intention to violate the law is necessary"); *SEC v. Martino*, 255 F. Supp. 2d 268, 285 (S.D.N.Y. 2003) ("The term 'willful' in the federal securities laws signifies merely that the defendant intended to commit the act which constitutes the violation.").

Bandimere points to our decision in *International Shareholders Serv. Corp.*, Exchange Act Release No. 12389, 1976 WL 160366 (Apr. 29, 1976), as support for his contention that he did not act willfully because he was unaware that his conduct violated the law. *International Shareholders* dealt with an exemption to the Section 5 registration requirements. The actions of the respondents in that case were consistent with the requirements of the exemption, but the exemption was rendered inapplicable (without the respondents' knowing it) by the acts of a third party. Under those very limited circumstances, we found that the respondents did not act willfully. *Id.* at *3-4. Here, Bandimere does not assert that any exemption applies, nor were his actions rendered illegal due to the actions of a third party. Thus, *International Shareholders* is inapposite.

[156] 15 U.S.C. § 78*o*(b)(4) (emphasis added).

latitude for the misconduct of an unregistered broker would only encourage persons to forego the mandate of registration. In any event, we have applied the *Wonsover* standard in other contexts,[157] including for violations that had no scienter or negligence requirement.[158]

Bandimere contends that "[t]he Commission need not articulate a precise standard of culpability" for a willful violation because he "was not culpable at all." We disagree. Bandimere's testimony that he "tried to be very careful to let [investors] know that [IVC and UCR] were not registered securities," shows his awareness that registration was an important consideration, thus undercutting his contentions that he lacked any awareness of possible wrongdoing. We also reject Bandimere's argument that he "acted reasonably" and was not culpable with respect to either the Section 5 or

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[157] *See, e.g.*, *Robert G. Weeks*, Exchange Act Release No. 48684, 2004 WL 828, at *12-13, *16 (Oct. 23, 2003) (*Wonsover* standard applied against former de facto officer and director of mining company).

[158] *See Maria T. Giesige*, Exchange Act Release No. 60000, 2009 WL 1507584, at *6 n.10 (May 29, 2009) (applying *Wonsover* standard to find willfulness with regard to Securities Act Section 5 violations); *Weeks*, 2004 WL 828, at *12-13, *16 (same); *John D. Audifferen*, Exchange Act Release No. 58230, 2008 WL 2876502, at *4-7 (July 25, 2008) (finding that the respondent "was aware of what he was doing and was not coerced," and thus acted willfully, when he violated several statutory provisions by taking actions that were permitted only upon a showing of compliance with Regulation T promulgated by the Governors of the Federal Reserve System; and further finding that although the evidence showed that the respondent knew or should have known that certain conduct would not comply with Regulation T, no such showing was required to establish that respondent acted willfully).

the Section 15(a) violations charged because he discussed "the legality of his activities" with Syke, an attorney, who testified that he failed to see that these activities raised possible issues involving the sale of investment contracts or acting as a broker. The discussions on which Bandimere relies happened early in Bandimere's involvement with IVC and UCR, so Syke's understanding of Bandimere's involvement was not based on Syke's knowledge of the full scope of activities in which Bandimere ultimately took part. And, although Syke had advised Bandimere that it was important to consider whether offers and sales of the IVC and UCR investments complied with federal securities laws, the record does not show that Bandimere sought Syke's advice with respect to this issue as he became more involved. To the contrary, Syke testified that he did not advise Bandimere whether he would be acting as an unregistered broker when he offered IVC and UCR investments to investors, and that he did not advise Bandimere that the offerings through Exito were in compliance with Section 5.

Bandimere argues that the onus is not on the client to disclose everything the lawyer must know to give advice on which a client may rely. He also argues, citing *Howard v. SEC*,[159] that compliance with the securities laws is sufficiently difficult that laymen have no real choice but to rely on counsel. But here, Bandimere's discussions with Syke alerted him to possible securities laws implications of Bandimere's involvement with selling IVC and UCR, and Bandimere chose not to pursue the assistance of counsel. This demonstrates that his conduct was unreasonable, rather than

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[159] 376 F.3d 1136, 1148 n.20 (D.C. Cir. 2004).

otherwise. In any event, whether Bandimere acted reasonably is irrelevant to the issue of willfulness because, as discussed above, there is no negligence requirement for a finding of willfulness.

Finally, even if we accepted Bandimere's arguments that his violations of Securities Act Section 5 and Exchange Act Section 15(a) were not willful (which we do not), our finding that Bandimere acted with scienter in violating the antifraud fraud provisions demonstrates willful violations sufficient to support our imposition of sanctions.

3. Barring Bandimere is in the public interest.

"In determining the need for sanctions in the public interest, we consider, among other things, (i) the egregiousness of the respondent's actions; (ii) the degree of scienter involved; (iii) the isolated or recurrent nature of the infraction; (iv) the respondent's recognition of the wrongful nature of his or her conduct; (v) the sincerity of any assurances against future violations; and (vi) the likelihood that the respondent's occupation will present opportunities for future violations."[160] We also consider whether the sanctions will have a deter-

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[160] *Donald L. Koch*, Exchange Act Release No. 72179, 2014 WL 1998524, at *20 (May 16, 2014) (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)), *aff'd in relevant part*, 793 F.3d 147 (D.C. Cir. 2015).

rent effect.[161] Our inquiry is flexible, and no single factor is dispositive.[162]

On the record before us, these factors support the imposition of a bar. Bandimere's conduct involved serious wrongdoing, at least a reckless degree of scienter, and was recurrent. Bandimere acted as an unregistered broker, selling unregistered securities, in numerous transactions over more than three years. By the time IVC and UCR stopped paying returns, the LLCs that Bandimere managed or co-managed had collected more than $9 million in investor funds, not including funds invested by Bandimere. Many of the investors who testified at the hearing stated that they lost most, if not all, of their investments in the two schemes, and that they were devastated by the outcome.[163]

Bandimere shows virtually no recognition of the wrongfulness of his conduct. In his brief, he calls his violations of Sections 5 and 15(a) "inadvertent if they occurred," refers to the requirements of Sections 5 and 15(a) as "technical," and says that he was "trying to be cautious." By referring to himself as a "victim," he

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[161] *See Toby G. Scammell*, Investment Advisers Act Release No. 3961, 2014 WL 5493265, at *5 (Oct. 29, 2014) (citing additional authority).

[162] *See KPMG Peat Marwick, LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at *26 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002).

[163] Although Bandimere argues that he also lost money because he had invested $1,145,419 in IVC and UCR programs, he in fact gained money as a result of his involvement because he received $477,878.93 paid out to him as "earnings" or "profits" on those investments, and an additional $734,996.33 in transaction-related compensation. We discuss Bandimere's gains and losses in more detail below.

disavows the part he played in causing losses to the investors he recruited to IVC and UCR. Although Bandimere has never been involved in the securities industry as a licensed professional, he is just as well positioned as he was before to pitch investments to his network of friends and acquaintances, which shows a possibility that there will be opportunities for future misconduct.

Bandimere argues against the use of the public interest factors articulated in *Steadman*, and insists that the D.C. Circuit rejected the *Steadman* factors as a basis for determining sanctions in *PAZ Securities v. SEC*.[164] But the court in *PAZ*—a case involving the review of sanctions imposed by the NASD—did not hold that consideration of the *Steadman* factors was in any way inappropriate. To the contrary, it found that those factors "will often be relevant."[165] The court held that the Commission was not constrained in explaining itself by reference to any mechanical formula, including *Steadman*.[166] Since deciding *PAZ*, the D.C. Circuit has denied petitions for review in which the Commission applied the *Steadman* factors in proceedings before ALJs, without indicating any disapproval of our use of those factors.[167] Bandimere's attack on our use of the *Steadman* factors is thus without merit.[168]

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[164] 566 F.3d 1172, 1175 (D.C. Cir. 2009).

[165] *Id.*

[166] *Id.*

[167] *See, e.g.*, *Peter Siris v. SEC*, 773 F.3d 89, 94, 97 (D.C. Cir. 2014) (noting Commission's application of "the multifactor test" set forth in *Steadman* and finding that Commission "cogently applied *Steadman*'s multifactor test"); *Armstrong v. SEC*, 476 F. App'x 864, 865 (D.C. Cir. 2012) (finding that *Steadman* sets out factors to con-

B. Cease-and-Desist Order

Section 8A(a) of the Securities Act and Section 21C(a) of the Exchange Act authorize us to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" those Acts or any rule promulgated thereunder.[169] In determining whether a cease-and-desist order is warranted, we consider not only the public interest factors discussed above, but also "'whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.'"[170] We also consider whether there is a reasonable likelihood of future violations, although the required showing of a risk of future violations in the context of a cease-and-desist order is significantly less than that required for an injunction, and "in the ordi-

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sider when Commission determines whether imposing an associational bar would serve the public interest); *Altman v. SEC*, 666 F.3d 1322, 1329 (D.C. Cir. 2011) (noting Commission's application of "the public interest standards set forth in *Steadman*").

[168] Bandimere argues that under *SEC v. First City Financial Corp., Ltd.*, 890 F.2d 1215, 1229 (D.C. Cir. 1989), "a failure to admit wrongdoing is not a legitimate consideration in determining appropriate relief." But *First City Financial* also noted that evidence that a defendant "did not feel bound by the law" was appropriately considered. Here Bandimere has characterized his serious violations as "technical" and has otherwise dismissed the seriousness of the conduct he admits, which makes us concerned that he is dismissive of the need to follow the law.

[169] 15 U.S.C. §§ 77h-1(a), 78u-3(a).

[170] *Koch*, 2014 WL 1998524, at *21 (citing *KPMG Peat Marwick, LLP*, 2001 WL 47245, at *24-26).

nary case, a finding of a past violation is sufficient to demonstrate a risk of future ones."[171] Our inquiry is flexible, and no single factor is dispositive.[172]

As we have already discussed, the application of the public interest factors demonstrates that Bandimere's conduct warrants significant sanctions. Turning to the additional factors relevant to cease-and-desist orders, we note that Bandimere's violations are relatively recent. Bandimere's conduct was harmful to investors: the testimony of investors Blackford and Moravec, each of whom lost about $300,000, most vividly demonstrates the harm done to them by their investments in IVC and UCR through Bandimere and his LLCs,[173] but other investors also testified as to losses of tens of thousands, or even hundreds of thousands, of dollars.[174] While Bandimere asserts in his brief that the record does not show that he is likely to involve others with investments after the disastrous consequences he experienced as a result of his involvement with IVC and UCR, he continues to downplay the wrongfulness of his actions. We thus find sufficient risk of future viola-

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[171] *KPMG Peat Marwick, LLP*, 2001 WL 47245, at *26.

[172] *Id.*

[173] Blackford testified that the loss represented a high percentage of his retirement savings, and that the loss caused great stress in his marriage and his personal life. Moravec testified that the impact of his losses had been "unbearable, to say the least"; that his life had been "totally devastated" by his losses, and that his life had been "turned upside down," because he had gone from anticipating a "comfortable" retirement to living in a "600-square foot, single-room cabin" in which he could only afford to install indoor plumbing within the past year.

[174] For example, Davis lost $20,000, and Radke lost $240,000.

tions to impose a cease-and-desist order in the public interest.

C. Disgorgement

In a cease-and-desist proceeding such as this one we "may enter an order requiring accounting and disgorgement, including reasonable interest."[175] Disgorgement is an equitable remedy that requires the violator to give up wrongfully obtained profits causally related to the wrongdoing at issue.[176] Because disgorgement is designed to return the violator to where he or she would have been absent the violative conduct,[177] disgorgement should include all of the gains that flow from the illegal activity.[178] The Division, in seeking disgorgement, must present a reasonable approximation of profits connected to the violation.[179] Any risk of uncertainty in calculating the disgorgement amount then falls on the wrongdoer, whose misconduct created the need for disgorgement.[180]

Bandimere does not take issue with the principle that one may be ordered to disgorge gains that are causally related to violative conduct. But he argues

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[175] 15 U.S.C. §§ 77h-1(e), 78u-3(e).

[176] *First City Fin.*, 890 F.2d at 1230 (citing additional authority). Ordering disgorgement may also deter others from violating the law. *Id.*

[177] *Zacharias v. SEC*, 569 F.3d at 471 ("[D]isgorgement restores the *status quo ante* by depriving violators of ill-gotten profits.").

[178] *Koch*, 2014 WL 1998524, at *22 (citing *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1113-14 (9th Cir. 2006)).

[179] *Id.*

[180] *Id.* (citing *Laurie Jones Canady*, Exchange Act Release No. 41250, 1999 WL 183600, at *10 n.35 (Apr. 5, 1999), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000)).

that he did not realize a "gain" subject to disgorgement because his involvement with IVC and UCR left him in a position of net financial loss. He claims that he should not be ordered to disgorge the management or brokerage fees he received, because even if he keeps them he will have lost money overall through his involvement with IVC and UCR. Disgorgement, he argues, would not deprive him of gains; it would merely increase his loss.

We are unwilling to offset the losses Bandimere incurred through his investments in IVC and UCR against the gains he made when IVC and Dalton paid him for his activities in brokering sales of the IVC and UCR investments. The "management fees" were paid to Bandimere to compensate him for his illegal activity in acting as an unregistered broker and selling unregistered securities. The fact that he lost funds that he invested in the fraudulent schemes does not persuade us that we should allow him to mitigate those losses by keeping the fees he got for his violative misconduct.[181]

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[181] We are not persuaded by Bandimere's reliance on *SEC v. Hately*, 8 F.3d 653 (9th Cir. 1993) and *SEC v. McCaskey*, 2002 WL 850001 (S.D.N.Y. Mar. 26, 2002). In *Hately*, the court held that ordering the petitioners to disgorge all of the commissions received by their firm was inappropriate where they received only 10% of the commissions. 8 F.3d at 654. That is distinguishable from the situation here in which Bandimere alone received the relevant illegal gains from his conduct in the form of "management fees" but also lost money through his own investments in the schemes. Similarly, *McCaskey* dealt only with profits and losses in a series of trades, 2002 WL 850001, at *10, and shines no light on the question whether two types of payments, such as the "management fees" and "investment returns" at issue here, should be netted against each other in calculating disgorgement.

In the context of determining the gains that flowed from his violations of the securities laws, it is appropriate to take the fees Bandimere received from his violative conduct as the measure of disgorgement.[182]

Bandimere argues that the compensation he received was too attenuated from any violation to be the proper subject of disgorgement because the compensation was for providing administrative services. Providing such services, he argues, was not illegal activity, so the remuneration does not represent ill-gotten gains and is therefore not subject to disgorgement. Bandimere further argues that the Division failed to provide the required reasonable approximation of the amount subject to disgorgement. He argues that the only record evidence regarding the amount of time he spent on such legitimate services as bookkeeping was his testimony that those services accounted for as much as 90% of the time he spent on matters related to IVC and UCR, and that thus at most 10% of the compensation he received should be subject to disgorgement.

We have already found that the fees Bandimere received were compensation for brokerage activity, and that Bandimere violated the federal securities laws by acting as an unregistered broker and selling unregistered securities. The administrative services Bandimere performed were in furtherance of his brokerage activity. His bookkeeping activities, for example, were

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[182] *Cf. William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752, at *24 (July 2, 2013) (finding that disgorgement based on total commissions retained by the broker was appropriate even when this amount exceeded the client's net loss in the account), *petition denied sub nom., Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014).

integral to his transmission of customer funds to Parrish and Dalton and his calculation of "returns" to be paid to investors. The record does not show, and Bandimere does not contend, that any of the compensation at issue related to anything other than the IVC and UCR investments. Thus, we find that the disgorgement figure provided by the Division (which was itself furnished by Bandimere, in a summary of the fees he received) was a reasonable approximation of Bandimere's ill-gotten gains. In the exercise of our discretion, we subtract, as did the ALJ, certain payments that Bandimere made to investors, and order disgorgement of $638,056.33, plus prejudgment interest.

D. Civil Money Penalties

Section 21B(a)(1) of the Exchange Act authorizes the Commission to impose a civil penalty in any proceeding instituted against a person pursuant to Exchange Act Section 15(b)(6) if it finds that the person has willfully violated any provision of the Securities Act or the Exchange Act or any rule thereunder.[183] We have found above that this proceeding was properly brought under Section 15(b)(6) and that Bandimere's violations were willful.[184] Second-tier penalties may be imposed if the violative act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, and third-tier penalties may be imposed if the act or omission also directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the

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[183] 15 U.S.C. § 78u-2(a)(1).

[184] *See supra* Sections VI.A.1 &2.

person who committed the act or omission.[185] Because Bandimere's conduct involved fraud and his activity resulted in substantial losses to others and substantial pecuniary gain to himself, third-tier penalties are authorized in this case.

In considering under Section 21B whether a penalty is in the public interest, we may consider (1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to other persons resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in Exchange Act Section 15(b)(4)(B); (5) the need to deter such person and other persons from committing such acts or omissions; and (6) such other matters as justice may require.[186]

Over a multi-year period, in dealings with multiple investors, Bandimere made baseless representations about the unregistered securities he was selling while

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[185] 15 U.S.C. § 78u-2(b).

[186] 15 U.S.C. § 78u-2(c).

failing to disclose negative factors associated with those investments. Through Bandimere, investors put some $9 million into the fraudulent schemes run by Parrish and Dalton, suffering losses that one investor described as devastating. Bandimere was unjustly enriched by the generous commissions he was paid for his work as an unregistered broker. Although we have determined that the imposition of an associational bar and a cease-and-desist order, as well as the assessment of disgorgement, are in the public interest, we find that imposing a civil penalty can have an additional deterrent effect beyond that of these other sanctions.[187]

Under these circumstances, we find, as the ALJ did, that the imposition of three third-tier civil penalties, one for each of the investment programs at issue (IVC, UCR trading program, and UCR diamond program), is in the public interest. For violations occurring between February 15, 2005 and March 3, 2009, the maximum penalty per violation for a natural person is $130,000 for a third-tier penalty; for violations occurring between March 4, 2009 and March 5, 2013, the maximum penalty for such a violation is $150,000.[188] While we have identified a number of factors that support a penalty at the high end of the range, we also rec-

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[187] Bandimere argues that he lost approximately $1 million in the IVC and UCR Ponzi schemes, and that no further deterrence is necessary. Those losses were a result of Bandimere's investment choices. The civil penalties serve the objective of deterrence from engaging in violations of the securities laws.

[188] *See* 17 C.F.R. §§ 201.1003, Table III (setting forth penalties for conduct occurring after February 14, 2005); 201.1004, Table IV (setting forth penalties for conduct occurring after March 3, 2009); 201.1005, Table V (setting forth penalties for conduct occurring after March 5, 2013).

ognize several factors that could justify reducing the penalty: Bandimere made limited repayments to investors (although those sums are small in comparison to the generous commissions he received); he has not been previously found to have violated the laws; and he, together with Syke, brought Parrish's misconduct with respect to IVC to the attention of the Commission. Although Bandimere testified that the imposition of a monetary sanction would change his economic position and probably cause him and his wife to seek employment, the financial impact of a disciplinary proceeding on the respondent is not a mitigating factor.[189]

Taking all these factors into account, we find that each of the three third-tier penalties should be in the amount of $130,000, for a total of $390,000. Since Bandimere's violative conduct continued after the permissible maximum penalties were adjusted upwards in March 2009, our use of this figure reflects our consideration of the mitigating factors we have noted.

An appropriate order will issue.[190]

By the Commission (Chair WHITE and Commissioners AGUILAR, STEIN, and PIWOWAR).

Brent J. Fields
Secretary

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[189] *Clifton*, 2013 WL 3487076, at *16 n.116.

[190] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

APPENDIX D

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9972 / Oct. 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76308 / Oct. 29, 2015

Admin. Proc. File No. 3-15124

In the Matter of
DAVID F. BANDIMERE

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that David F. Bandimere be barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent, and it is further

ORDERED that Bandimere cease and desist from committing or causing any violations or future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder; and it is further

ORDERED that Bandimere disgorge $638,056.33, plus prejudgment interest of $128,367.47, such prejudgment interest calculated beginning from February

1, 2010, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Bandimere pay a civil money penalty of $390,000.

Payment of the amounts to be disgorged and the civil money penalties shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 15-9586

DAVID F. BANDIMERE, PETITIONER

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

IRONRIDGE GLOBAL IV, LTD;
IRONRIDGE GLOBAL PARTNERS, LLC, AMICI CURIAE

[Filed: May 3, 2017]

ORDER

Before TYMKOVICH, Chief Judge, KELLY, BRISCOE, LUCERO, HARTZ, HOLMES, MATHESON, BACHARACH, PHILLIPS, MCHUGH, and MORITZ, Circuit Judges.

This matter is before the court on the Security and Exchange Commission's *Petition for Rehearing or Rehearing En Banc*. We also have a response from the petitioner. Upon consideration, the request for panel rehearing is denied by a majority of the original panel members.

The petition and response were also transmitted to all the judges of the court who are in regular active service. Upon that circulation, a poll was called. A

majority voted to deny en banc reconsideration. *See* Fed. R. App. P. 35(a). Consequently, the en banc request is likewise denied.

Judges Lucero and Moritz voted to grant en banc rehearing. Judge Lucero has written separately in dissent, in which Judge Moritz joins.

Entered for the Court

/s/ ELISABETH A. SHUMAKER
ELISABETH A. SHUMAKER, Clerk

15-9586, Bandimere v. U.S. SEC

LUCERO, J., joined by **MORITZ**, J., dissenting from the denial of rehearing en banc.

Because this request for rehearing en banc presents numerous questions of constitutional importance, it is my view that we should rehear the matter. First, the panel majority opinion fails to accord proper deference to the constitutional structure of checks and balances and agency separation of functions that flow from that fundamental construct. Second, the panel decision needlessly and improvidently expands the reach of Freytag v. Commissioner, 501 U.S. 868 (1991), which involved judges on the Tax Court, to the unrelated issue of agency administrative law judges ("ALJs"). In light of the significant consequences of this decision, it is not our office to expand the holding in Freytag, to the contrary, any such expansion should remain in the sole discretion of the Supreme Court. Third, the impact of this opinion will be substantial, and it presents a threat of disruption throughout our government. Finally, the majority opinion fails to respect the carefully crafted procedural protections that are incorporated in the Administrative Procedure Act ("APA"), an essential condition of the congressional delegation of authority to administrative agencies.

For each of these reasons, en banc review is not only appropriate, but necessary. That the Supreme Court may ultimately review this case does not relieve us of our independent obligation to rehear it. For the foregoing reasons, I respectfully dissent from the denial of en banc review.

I

As James Madison observed, "The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny." The Federalist No. 47, at 324 (James Madison) (J. Cooke ed., 1961). To prevent the tyranny against which Madison admonished, the founders crafted a constitutional division of authority among three co-equal branches of government, controlled by a series of checks and balances. The panel opinion in this case not only veers away from that constitutional structure, it aggregates power in administrative agency officials contrary to this Madisonian principle.

In the face of a rapidly growing and largely unregulated body of administrative law during the first half of the twentieth century, and concerns about the commingling of functions within administrative agencies, Congress enacted the APA, which provides governing principles. As observed by Senator Pat McCarran in the foreword to the APA's compiled legislative history, the Act was celebrated as "a comprehensive charter of private liberty and a solemn undertaking of official fairness" that "enunciates and emphasizes the tripartite form of our democracy." Administrative Procedure Act Legislative History, at iii (1946).

The need to maintain separation of functions was felt particularly in the area of agency adjudication, and a significant concern motivating the drafters of the APA was the perceived bias of administrative adjudicators. "Many complaints were voiced against the actions of the hearing examiners, it being charged that

they were mere tools of the agency concerned and subservient to the agency heads in making their proposed findings of fact and recommendations." Ramspeck v. Fed. Trial Exam'rs Conference, 345 U.S. 128, 131 (1953).[1] Prior to the APA, hearing examiners were "employees of an agency, their classification was determined by the ratings given them by the agency, and their compensation and promotion depended upon their classification." Ramspeck, 345 U.S. at 130. Accordingly, "[t]he examiners were in a dependent status." Id. As the Supreme Court has long recognized, "one who holds his office only during the pleasure of another cannot be depended upon to maintain an attitude of independence against the latter's will." Humphrey's Ex'r v. United States, 295 U.S. 602, 629 (1935).

A 1937 Report of the President's Committee on Administrative Management cogently articulates the concerns:

> There is a conflict of principle involved in [the agencies'] make-up and functions. They are vested with duties of administration and at the same time they are given important judicial work. The evils resulting from this confusion of principles are insidious and far reaching. Pressures and influences properly enough directed toward officers responsible for formulating and administering policy constitute an unwholesome atmosphere in which to adjudicate private rights. But the mixed duties of the commissions render escape from these subversive influ-

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[1] ALJs were previously referred to as "hearing examiners." See Eifler v. Office of Workers' Comp. Programs, 926 F.2d 663, 665 (7th Cir. 1991).

> ences impossible. Furthermore, the same men are obliged to serve both as prosecutors and as judges. This not only undermines judicial fairness; it weakens public confidence in that fairness. Commission decisions affecting private rights and conduct lie under the suspicion of being rationalizations of the preliminary findings with the Commission, in the role of prosecutor, presented to itself.

S. Rep. No. 79-752 (1945), as reprinted in Administrative Procedure Act Legislative History 189 (quotation and ellipses omitted). In light of these concerns, the APA authors adopted the view that the "commingling of functions of investigation or advocacy with the function of deciding [was] plainly undesirable" and should be remedied by "isolating those who engage in the activity" of adjudication via independent hearing officers. S. Comm. on the Judiciary, 79th Cong., Rep. on Admin. Procedure Act (Comm. Print 1945), as reprinted in Administrative Procedure Act Legislative History 25 (quotation and ellipses omitted).

The majority opinion undermines this well-established structure of ALJ independence, and places the legitimacy of our administrative agencies in serious doubt. Whether SEC ALJs exercise the "significant authority" necessary to constitute inferior officers, Bandimere v. U.S. SEC, 844 F.3d 1168, 1173 (10th Cir. 2016), should be informed not just by their daily duties, but by the independent guardrails of our constitutional structure, to wit, the separation of functions within administrative agencies. The majority opinion notes that the Appointments Clause reflects "both separation of powers and checks and balances" concerns, and "promotes public accountability." Id. at 1172. But my respected col-

leagues in the majority fail to appreciate that these are the very principles embodied in the current structure and process governing selection of ALJs.

II

In light of the very real and substantial consequences, labeling SEC ALJs "inferior officers" for the first time in the near-century of their existence should not be done without a clear mandate from the Supreme Court. As demonstrated by the dissenting panel opinion, any such mandate is far from clear.

The Supreme Court case at the heart of this dispute involved special trial judges of the Tax Court, an Article I court, and it did not consider administrative agencies or ALJs. Freytag, 501 U.S. at 870. Thus, the majority opinion greatly expands the reach of that decision by equating those Article I judges with ALJs, intermediate hearing officers adjudicating cases for further agency disposition. The many specific bases for distinguishing SEC ALJs from the special trial judges in Freytag are outlined in detail in the dissenting panel opinion. See Bandimere, 844 F.3d at 1194-98 (McKay, J., dissenting). I will not repeat them here, but I emphatically agree with the dissent that it is far from clear Freytag compels a conclusion that SEC ALJs are inferior officers.

Countless cases have been decided in the decades since the structure of regulatory agencies and commissions was first established. Many more have been decided since the Supreme Court's decision in Freytag. Each of these cases has been decided in the context of the very constitutional provisions at issue in this case, and none has concluded that Freytag should be ex-

tended in this manner. As the Supreme Court has advised, "long settled and established practice is a consideration of great weight in a proper interpretation of constitutional provisions." N.L.R.B. v. Noel Canning, 134 S. Ct. 2550, 2559 (2014) (alteration omitted). Giving little regard to the longstanding practices implicated in this case, the majority opinion places the legitimacy of our administrative agencies in serious doubt, based on little more than three sentences in a decades-old Supreme Court decision. See Bandimere, 844 F.3d at 1175-76 (majority opinion) (citing Freytag, 501 U.S. at 881-82). I must agree with the dissent that, without a clearer mandate from the Supreme Court, we should "prefer the outcome that does the least mischief." Id. at 1201 (McKay, J., dissenting).

III

In addition to undermining the constitutional foundations and structure of the SEC, the majority opinion "risks throwing much into confusion," id. at 1200, and is likely to have a substantial and disruptive impact on the daily functioning of administrative agencies. There are currently over 1,500 ALJs working in at least 28 different federal agencies, presiding over hundreds of thousands of agency adjudications each year. See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 586-87, app. C (2010) (Breyer, J., dissenting); Kent Barnett, Resolving the ALJ Quandary, 66 Vand. L. Rev. 797, 799 (2013). Despite the majority's best efforts to cabin its decision to SEC ALJs alone, see Bandimere, 844 F.3d at 1188 (majority opinion), the majority opinion will undoubtedly cause the legitimacy of all federal ALJs to come under attack. Since the issuance of this decision, we have already

seen one emergency request for relief from an SEC administrative enforcement proceeding. Kon v. SEC, No. 17-3066 (10th Cir. Mar. 31, 2017) (unpublished). It is only a matter of time before we see broader challenges to the validity of agency action.

Consequently, I share the dissent's concern that the majority opinion will be used to conduct a broader assault on our time-tested administrative system. ALJ insulation from agency control and coercion was a primary goal of the APA. However, a probable consequence of the majority opinion is the loss of ALJ independence and political insulation on multiple levels. In particular, the majority ruling threatens to endanger ALJs' double for-cause protection. In Free Enterprise Fund, the Supreme Court determined that "dual for-cause limitations on the removal" of certain inferior officers is unconstitutional. 561 U.S. at 492. Justice Breyer warned in his dissent that the decision could be extended to ALJs, potentially giving "every losing party before an ALJ . . . grounds to appeal on the basis that the decision entered against him is unconstitutional." Id. at 536, 542-43 (Breyer, J., dissenting). The Free Enterprise Fund majority responded that ALJs are not necessarily inferior officers, thereby providing courts with a clear path to avoid extending its holding to ALJs. See id. at 507 n.10 (majority opinion). The panel majority opinion eliminates that path and brings us one step closer to realizing Justice Breyer's concern.

The panel concurrence suggests other potential avenues that courts might use to avoid making ALJs fully subject to the political pressure of agency heads. See Bandimere, 844 F.3d at 1191 (Briscoe, J., concurring).

But on a fundamental level, the consequence of this decision—providing agency heads with the sole power to appoint ALJs of their choosing—threatens the integrity of the ALJ office. Further agency control over ALJs may create an unconstitutional appearance of partiality and implicate serious due process concerns. By pulling on the Appointments Clause thread, the majority opinion threatens to unravel much of our modern regulatory framework. This unraveling is justified on the basis of the discretion enjoyed by ALJs in their day-to-day decisional work. But this fails to recognize that any discretion of the ALJs is subject to final acceptance or review by the agency itself. Any administrative agency discretion exercised by any employee of the agency is always subject to the final decisional discretion vested in the members and heads of agencies.

IV

As described supra, the APA was thoughtfully constructed to ensure maximum independence for ALJs during their decision-making process, thereby providing an administrative separation of functions that mirrors the constitutional separation of powers. To achieve ALJ impartiality and maintain an intra-agency separation of functions, the APA affirmatively separates the investigative and prosecutorial functions of the agency from its formal adjudicatory functions. It provides that "[a]n employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review." 5 U.S.C. § 554(d). Further, an ALJ may not "be responsible to or subject to the supervision or direction of an employee or agent

engaged in the performance of investigative or prosecuting functions for an agency." § 554(d)(2). To this end, ALJs are hired through a merit-selection process administered by the Office of Personnel Management, 5 U.S.C. § 1302; 5 C.F.R. § 930.201, and they may be fired only by the Merit Systems Protection Board for good cause, 5 U.S.C. § 7521. Congress enacted these provisions with the express purpose of "render[ing] examiners independent and secure in their tenure and compensation." S. Rep. No. 79-752 (1945), as reprinted in Administrative Procedure Act Legislative History 215.

At the same time, the Act vests ultimate decisional authority and discretion in the agencies themselves, thereby promoting public accountability. See § 557(b) ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule."). In the apt words of the panel dissent, "it is quite clear where the buck stops." Bandimere, 844 F.3d at 1198 (McKay, J., dissenting). The discretion exercised by the governing head of an agency unquestionably trumps any authority exercised by the ALJs, satisfying the policy concerns that motivated the Appointments Clause. Congress' carefully crafted framework thus neatly threads the needle, ensuring integrity in the decision-making process and political accountability as to its outcome.

The majority opinion undoes much of this constitutional structure by failing to respect Congress' delegation of authority to agencies, as contemplated by the agencies' organic acts and the APA, and by scuttling the statutory requirements based on a misreading of Freytag. The APA was a thoughtfully crafted and

hard-fought compromise. It was under consideration for more than ten years, and "no measure of like character has had the painstaking and detailed study and drafting." H.R. Rep. No. 79-1980 (1946), as reprinted in Administrative Procedure Act Legislative History 241. Congress considered multiple different and competing proposals before ultimately adopting the procedure now codified in the APA, id., a procedure that has mandated a specific process for the appointment of ALJs for more than seventy years.

That procedure is observed by the securities laws governing the operations of the SEC, which provide that final adjudicative power rests exclusively in the five members of the Commission itself. See Bandimere, 844 F.3d at 1197 (summarizing the role of SEC ALJs as mandated by 17 C.F.R. §§ 201.360(a)(1), 201.411(a), & 201.400(a)). The role of ALJs within the SEC thus exemplifies the model of administrative adjudication that Congress selected and memorialized in the APA. As discussed supra, Congress made specific and deliberate choices to structure the appointment of ALJs in a constitutionally sound manner. The panel majority pays too little deference to those congressional dictates.

V

The majority opinion will have an overwhelming impact on the fundamental structure of administrative agencies and the administrative process. A case that grapples with such substantial questions of constitutional law and realigns separation of function principles deserves the consideration of our full court.