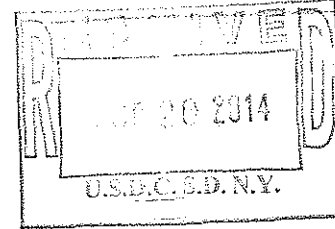


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JUDGE PAULEY

14 CV 8364

**UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**



JORDAN PEIXOTO,

14-cv-

Plaintiff,

**COMPLAINT FOR  
DECLARATORY AND  
INJUNCTIVE RELIEF AND  
DEMAND FOR JURY TRIAL**

-against-

**SECURITIES AND EXCHANGE  
COMMISSION,**

Defendant.

Jordan Peixoto, for his complaint against the Securities and Exchange Commission (the "Commission" or "SEC"), alleges as follows:

**Introduction**

1. Mr. Peixoto brings this action for declaratory and injunctive relief to avoid being required to submit to an unconstitutional proceeding, to prevent the Commission from violating his due process rights and his rights of equal protection under the law afforded by the Constitution of the United States of America, and from suffering irreparable reputational and financial harm—all without meaningful judicial review.

2. On September 30, 2014, the Commission formally alleged that Mr. Peixoto engaged in insider trading in connection with the securities of Herbalife Ltd. by serving Mr. Peixoto with an Order Instituting Cease-and-Desist Proceedings pursuant to Section 21C of the Securities and Exchange Act of 1934 (the "OIP") (*In the Matter of Jordan Peixoto*, Administrative Proceeding File No. 3-16184) before an SEC Administrative Law Judge ("SEC ALJ") at the Commission to determine, *inter alia*, whether Mr. Peixoto should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act and whether Mr. Peixoto should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Act.

3. Pursuant to the Commission's Rules of Practice, Mr. Peixoto is required to submit an Answer to the OIP on or about November 23, 2014. Mr. Peixoto has not served an Answer at this time.

4. SEC administrative proceedings violate Article II of the U.S. Constitution, which states that the "executive Power shall be vested in a President of the United States of America."

5. An SEC ALJ, appointed for a life-term tenure, presides over an administrative proceeding. Statutes and regulations make clear that SEC ALJs are executive branch "officers" within the meaning of Article II. SEC ALJs are not mere recommenders to the Commission or mere employees performing fact-gathering exercises for final review by the Commission; rather, they have enormous and practically unchecked authority. Moreover, there is no obvious constitutional warrant for such unchecked and unbalanced administrative power. *See S.E.C. v. Citigroup Global Markets Inc.*, 11-CV-7387 JSR, 2014 WL 3827497 (S.D.N.Y. Aug. 5, 2014).

6. The SEC ALJ position is established by law and the duties, salary, and means of appointment for the office are specified by statute. They have the power to take testimony, conduct hearings, rule on the admissibility of evidence, and have the power to enforce

compliance with discovery orders. The SEC ALJ can render punishment, including civil money penalties and ban an individual for life from the securities business. In the course of carrying out those functions, the SEC ALJs exercise significant discretion.

7. They cannot be removed “at will” by the Commission but can only be removed for “good cause.” The SEC’s own Rules of Practice provide the SEC ALJs with enormous authority over Mr. Peixoto in this proceeding and the Commission’s review of the SEC ALJs’ decision affords that judgment with tremendous deference. In effect and practice, the SEC ALJ renders the decision of the Commission in administrative proceedings. An appointee exercising significant authority pursuant to the laws of the United States is an officer of the United States. *Landry v. FDIC.*, 204 F.3d 1125, 1133, 340 U.S. App. D.C. 237, 245 (2000) (citing *Buckley v. Valeo*, 424 U.S. 1, 216 n. 162, 96 S. Ct. 612 (1976)).

8. The Supreme Court has held that such officers – charged with executing the laws, a power vested by the Constitution solely in the President – may not be separated from Presidential supervision and removal by more than one layer of tenure protection. *Free Enterprise Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 561 U.S. 477 (2010) (“*Free Enterprise*”). In particular, if an officer can only be removed from office for good cause, then the decision to remove that officer cannot be vested in another official, who, too, enjoys good-cause tenure. *Id.*

9. Yet, SEC ALJ’s enjoy at least two (and potentially more) layers of tenure protection. The SEC administrative proceedings therefore violate Article II and are unconstitutional.

10. Additionally, as discussed herein, the Commission has singled out Mr. Peixoto for disparate treatment in comparison to similarly situated persons, and there is no rational relationship between the disparate treatment and a legitimate government interest.

11. Without any rational basis, the Commission seeks, among other things, civil penalties from Mr. Peixoto in an administrative proceeding rather than a federal court action, an approach that the Commission has not taken against any other non-regulated person in a litigated proceeding for insider trading since Rajat Gupta (Admin. Proc. File No. 3-14279) in 2011, whose case the Commission ultimately transferred to district court following his attorneys commencing an action alleging violation by the Commission of his equal protection and due process rights. In so doing, the Commission has unfairly and unconstitutionally singled out Mr. Peixoto. With the exception of Gupta and arguably one other settling defendant, the Commission has filed all litigated insider trading proceedings against non-regulated defendants in district court since the passage of Dodd-Frank in July 2010. This means the Commission has gone to district court to make allegations against 156 non-regulated insider trading defendants since Dodd-Frank.<sup>1</sup>

12. Mr. Peixoto denies all allegations of wrongdoing and stands ready to mount a defense against each and every one of the Commission's allegations. Yet, under current Commission rules, Mr. Peixoto would be deprived of a jury trial, the right to use the discovery procedures of the federal court to shape his defense, and the protections of the Federal Rules of Evidence which were crafted to bar unreliable evidence. The Commission is denying Mr. Peixoto these rights, even though the General Counsel of the Commission, Anne K. Small, specifically acknowledged in a public forum merely four months ago speaking to members of the

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<sup>1</sup> Section 929P of Dodd-Frank amended Section 8A of the Securities Act of 1933, Section 21B(a) of the Securities Exchange Act of 1934, Section 9(d)(1) of the Investment Company Act of 1940 and Section 203(i)(1) of the Investment Advisers Act of 1940 to permit the Commission prospectively to seek civil penalties against non-regulated persons in administrative cease-and-desist proceedings under those statutes.

District of Columbia bar that the current administrative proceeding rules are inadequate for an insider trading case. In a question and answer session between Small and members of the District of Columbia Bar, Small stated that it was fair for attorneys to question whether the SEC's rules for administrative proceedings were still appropriate, with the rules last revised "quite some time ago," especially as the rules do not consider complex matters such as insider trading cases. See Daniel Wilson, *SEC Administrative Case Rules Likely Out Of Date, GC Says*, Law360, June 17, 2014, attached hereto and incorporated herein as Exhibit A.

13. Mr. Peixoto, unlike other non-regulated defendants charged by the SEC in insider trading cases, faces a proceeding where the rules prevent the administrative law judge from setting a reasonable trial schedule and issuing other appropriate rulings given the nature and complexity of the case. The case against Mr. Peixoto is a highly complex insider trading action, which, by all account, involves a broad, multi-year investigation of Herbalife and trading activity surrounding the stock in that company.

14. Counsel for Mr. Peixoto has conferred with representatives of the Commission and they have offered no explanation as to why Mr. Peixoto is being singled out for disparate treatment, even when presented with clear data showing disparate treatment, or to articulate a reason why it was proper to bring the case against Mr. Peixoto in the AP rather than in district court. In the absence of an explanation, we are left with the Commission's apparent motives and they are improper.

15. In fact, we do not need to look far to discern those motives because the Commission has publicly indicated them. In a "Discussion with Andrew Ceresney," Director of Enforcement, SEC, moderated by Larry Ellsworth, Partner, Jenner & Block, to members of the D.C. Bar in June 2014, regarding the administrative process, Mr. Ceresney stated: "I will tell you

that there have been a number of cases in recent months where we have threatened administrative proceedings, it was something we told the other we were going to do and they settled.” See Brian Mahony, *SEC Could Bring More Insider Trading Cases In-House*, Law360, June 11, 2014, attached hereto and incorporated herein as Exhibit B. In other words, the Commission itself unashamedly and, importantly, unlawfully wields the sword of an improper proceeding against defendants to compel settlement. The Commission is fully aware and has acknowledged that the administrative process is a star chamber where only the Commission emerges as the victor and the defendant is defenseless. The mere specter of the process renders submission from the defendant because the process is rigged against him. Here, the Commission is consciously doing exactly what the SEC Director of Enforcement indicated, by attempting to unfairly force Mr. Peixoto to settle, despite his case for innocence and without regard to the disparate treatment established by the data, thus, establishing discriminatory intent and impact.

16. In short, the Commission intentionally and strategically singled out Mr. Peixoto by bringing this case as an AP and effectively tying his hands behind his back. The best evidence that the Commission’s case against Mr. Peixoto belongs in this Court is that the Commission has otherwise brought every comparable case in federal district court.

17. Furthermore, the Commission intentionally is commencing an action against Mr. Peixoto in a forum that it has every reason to know violates Article II of the Constitution of the United States of America.

**Jurisdiction, Venue, and Parties**

18. This Court has subject matter jurisdiction over this action pursuant to 28 U.S.C. §§ 1331, 1337, 1346, 1361 and 2201, and 5 U.S.C. §§ 702 and 706. Venue is proper in this district pursuant to 28 U.S.C. 1391(b) and (e).

19. It is appropriate and necessary for this Court to exercise jurisdiction over Plaintiff's claims because, *inter alia*, Plaintiff alleges constitutional violations. Additionally, this Court's jurisdiction is necessary because: (a) without this Court's review at this stage, meaningful judicial review will be foreclosed; (b) Plaintiff's claims are wholly collateral to the review provisions of the securities laws; and (c) Plaintiff's claims are not within the particular expertise of the SEC. *See Free Enterprise*, 139 S. Ct. at 3150.

20. Mr. Peixoto is a natural person, a resident of Toronto, and a Canadian citizen. During December 2012 (the "Relevant Time Period"), Mr. Peixoto resided in New York, New York on a H-1B visa. During the Relevant Time Period, Mr. Peixoto was employed as a senior consultant at Deloitte Consulting LLP ("Deloitte") in New York.

21. The SEC is an agency of the United States government, headquartered in Washington, D.C.

**Background**

22. Mr. Peixoto is a 30 year-old resident of Toronto and a Canadian citizen. In 2006, Mr. Peixoto obtained his undergraduate degree in Commerce from the University of Manitoba. In 2007, Mr. Peixoto moved to New York and accepted a consulting position with Deloitte, consulting healthcare industry clients. In or about 2011, through a mutual friend, Mr. Peixoto socially met Filip Szymik ("Szymik"). The two lived near each other and formed a friendship, and would occasionally meet for drinks on weekend nights. In September 2013, Mr. Peixoto,

seeking to pursue a career in finance, enrolled in the Rotman School of Management's MBA program, in Toronto, Canada, where he is currently matriculated.

**The Order Instituting Proceedings' Allegations Against Mr. Peixoto**

23. On September 30, 2014, the Commission issued an OIP through which the Commission commenced an administrative proceeding against Mr. Peixoto, before a SEC ALJ, seeking a cease-and-desist order, disgorgement, and civil penalties. Attached hereto and incorporated herein as Exhibit C is the OIP.

24. The OIP alleges that Mr. Peixoto engaged in insider trading by purchasing options in advance of a public presentation by a hedge fund, Pershing Square Management, L.P. ("Pershing"), indicating the reasons it was betting against the stock of Herbalife Ltd. ("Herbalife"). The OIP alleges, in particular, that a Pershing analyst (the "Analyst"), in violation of Pershing's internal confidentiality policy, disclosed to his roommate, Filip Szymik ("Szymik"), that Pershing had a negative view of Herbalife, which it would soon publicly disclose in a presentation. Szymik, who was a social friend of Mr. Peixoto, is said to have breached a "duty of trust" to the Analyst by conveying this information to Mr. Peixoto. The OIP concludes that Mr. Peixoto committed insider trading by purchasing Herbalife put options while in possession of this "material nonpublic information," which he had "reason to know . . . had been improperly obtained." Mr. Peixoto unequivocally denies all charges.

25. The SEC's insider trading case against Mr. Peixoto is highly attenuated on both the law and the facts. The case represents the SEC's attempt to expand the boundaries of existing insider trading law. Never before has the SEC charged an individual with trading in advance of a private hedge fund's disclosure of its investment plan. The SEC's theory of liability hinges upon a view that Mr. Peixoto is liable because the purported intimate relationship



of trust and confidence between the Analyst and Szymik created a duty imposed on Mr. Peixoto that would have forbidden any such trading. The SEC has failed to charge the Analyst who disclosed the purported material inside information. Instead, the SEC has charged Mr. Peixoto, who the SEC fails to allege was ever told and, we submit, had no reason to believe that the information was confidential.

26. The SEC brings these insider trading charges administratively, rather than in district court, because it could not carry its burden of proving to a jury the required elements of an insider trading offense in this matter. The SEC could not prove, by Federal Rules of Evidence standards, that Mr. Peixoto possessed the requisite scienter. The SEC could not prove that Mr. Peixoto knew or should have known that Szymik and the Analyst had the type of intimate friendship which gives rise to a duty of confidentiality, or that Szymik breached any such purported duty. Nor could the SEC establish that Mr. Peixoto knew or should have known that whatever information Szymik conveyed to him was confidential.

27. Similarly, the SEC cannot prove the existence of a duty of trust and confidence—another required element of insider trading charges. Szymik and the Analyst provided conflicting, and self-serving, testimony as to whether Szymik promised to keep information he learned from the Analyst confidential. Similarly, the SEC has scant, if any, evidence that Szymik and the Analyst shared the type of intimate friendship that gives rise to a duty of confidentiality. And if Szymik was under no legal duty to keep the information confidential, Mr. Peixoto cannot be held liable for insider trading as a matter of law.

28. Additionally, the SEC cannot prove that the information in question was material. The OIP alleges that Szymik told Mr. Peixoto that Pershing was preparing a public presentation about Herbalife, and that the presentation was negative. However, during his SEC investigation

testimony, Szymik repeatedly emphasized that the Analyst did not specify that Pershing's view was negative. The mere fact that a private hedge fund intends to take a position in the market, without knowing the direction of that position, is hardly material information sufficient to support an insider trading charge.

29. The SEC's flawed case against Mr. Peixoto rests upon the unreliable evidence of conflicting, self-serving testimonies of Szymik and the Analyst, the occurrence of phone calls between Mr. Peixoto and Szymik, and ambiguous text messages. The case does not involve the minutiae of securities laws or the inner workings of the securities industry—areas in which SEC ALJs, arguably, have expertise. Rather, the charges against Mr. Peixoto primarily depend on credibility and other fact-finding determinations that are the primary function of jury trials. Nevertheless, the SEC chose to charge Mr. Peixoto in an administrative proceeding. In light of the SEC's meager and inconsistent evidence against Mr. Peixoto, this is no surprise.

**The SEC's Chosen Forum Violates the Appointments Clause of the Constitution**

30. On or about September 30, 2014, the SEC staff indicated to undersigned counsel for Mr. Peixoto the Commission's intent to file charges against him immediately and likely within twenty-four hours. The only alternative for Mr. Peixoto would have been to agree to draconian settlement terms that, in effect, undermine his case for innocence and destroy his career in business and finance.

31. During the same September 2014 conversation, the SEC staff also informed counsel that the Commission would do so in an SEC administrative proceeding, rather than in federal district court.

***The Administrative Proceeding***

32. An administrative proceeding is an internal SEC hearing, litigated by SEC trial attorneys and governed by the SEC's Rules of Practice ("Rules of Practice," or "RoP"), in which an SEC ALJ serves as finder of fact and of law.

33. Unlike federal court, administrative proceedings do not afford juries to litigants.

34. The Federal Rules of Civil Procedure do not apply in an administrative proceeding; they do apply in federal court.

35. Similarly, the Federal Rules of Evidence do not apply in an administrative proceeding as they do in federal court. Any evidence that "can conceivably throw any light upon the controversy," including hearsay, "normally" will be admitted in an administrative proceeding. *In the Matter of Jay Alan Ochanpaugh*, Exchange Act Rel. No. 54363, 2006 SEC LEXIS 1926, \*23 n.29 (Aug. 25, 2006).

36. Discovery is limited in administrative proceedings. Unlike in federal court, depositions are generally not allowed. RoP 233, 234.

37. The SEC Rules of Practice do not provide respondents the opportunity to test the SEC's legal theories before trial via motions to dismiss, which are available in federal court.

38. The SEC Rules of Practice do not allow respondents to assert counterclaims against the SEC. Federal court defendants may assert counterclaims against their adversaries.

39. The SEC Rules of Practice require the hearing to take place, at most, approximately four months from the issuance of the SEC's OIP. In its discretion, the SEC can require the hearing to occur as early as one month after the OIP is issued. The SEC does not need to start making available the limited discovery afforded to administrative proceeding respondents until seven days after the OIP is issued.

40. Some observers have found that the SEC has succeeded much more often in administrative proceedings, where it enjoys the procedural advantages described above, than in federal district courts. Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES, Oct. 5, 2013.

41. Any appeal from the SEC ALJ's decision goes to the SEC itself: the very body which, prior to the administrative proceeding, determined that an enforcement action was warranted – and the SEC is empowered to decline to hear the appeal, or to impose even greater sanctions. A final order of the Commission, after becoming effective, may then be appealed to a United States Court of Appeals.

#### **SEC ALJs**

42. SEC ALJs, who preside over administrative proceedings, exercise authority and discretion that makes them officers for the purposes of Article II of the U.S. Constitution.

#### ***Broad Discretion to Exercise Significant Power***

43. SEC ALJs enjoy broad discretion to exercise significant authority with respect to administrative proceedings. Under the SEC Rules of Practice, an SEC ALJ – referred to in the Rules of Practice as the “hearing officer” – is empowered, within his or her discretion, to perform the following, among other things:

- a. Take testimony. RoP 111.
- b. Conduct trials. *Id.*
- c. Rule on admissibility of evidence. RoP 320.
- d. Order production of evidence. RoP 230(a)(2), 232.

- e. Issue orders, including show-cause orders. *See, e.g.*, 17 CFR 201.141 (b); In the Matter of China Everhealth Corp., Admin. Proc. Rel. No. 1639, 2014 SEC LEXIS 2601 (July 22, 2014).
- f. Rule on requests and motions, including pre-trial motions for summary disposition. *See, e.g.*, RoP 250(b).
- g. Grant extensions of time. RoP 161.
- h. Dismiss for failure to meet deadlines. RoP 155(a).
- i. Reconsider their own or other SEC ALJs' decisions. RoP 111 (h).
- j. Reopen any hearing prior to the filing of a decision. RoP 111 G).
- k. Amend the SEC's OIP. RoP 200(d)(2).
- l. Impose sanctions on parties for contemptuous conduct. RoP 180(a).
- m. Reject filings that do not comply with the SEC's Rules of Practice. RoP 180(b).
- n. Dismiss the case, decide a particular matter against a party, or prohibit introduction of evidence when a person fails to make a required filing or cure a deficient filing. RoP 180(c).
- o. Enter orders of default, and rule on motions to set aside default. RoP 155.
- p. Consolidate proceedings. RoP 201(a).
- q. Grant law enforcement agencies of the federal or state government leave to participate. RoP 210(c)(3).
- r. Regulate appearance of amici. RoP 210(d).
- s. Require amended answers to amended OIPs. RoP 220(b).
- t. Direct that answers to OIPs need not specifically admit or deny, or claim insufficient information to respond to, each allegation in the OIP. RoP 220(c)

- u. Require the SEC to file a more definite statement of specified matters of fact or law to be considered or determined. RoP 220(d).
- v. Grant or deny leave to amend an answer. RoP 220(e).
- w. Direct the parties to meet for prehearing conferences, and preside over such conferences as the ALJ “deems appropriate.” RoP 221(b).
- x. Order any party to furnish prehearing submissions. RoP 222(a).
- y. Issue subpoenas. RoP 232.
- z. Rule on applications to quash or modify subpoenas. RoP 232(e).
- aa. Order depositions, and act as the “deposition officer.” RoP 233, 234.
- bb. Regulate the SEC’s use of investigatory subpoenas after the institution of proceedings. RoP 230(g).
- cc. Modify the Rules of Practice with regard to the SEC’s document production obligations. RoP 230(a)(1).
- dd. Require the SEC to produce documents it has withheld. RoP 230(c).
- ee. Disqualify himself or herself from considering a particular matter. RoP 112(a).
- ff. Order that scandalous or impertinent matter be stricken from any brief or pleading. RoP 152(f).
- gg. Order that hearings be stayed while a motion is pending. RoP 154(a).
- hh. Stay proceedings pending Commission consideration of offers of settlement. RoP 161 (c)(2).
- ii. Modify the Rules of Practice as to participation of parties and amici. RoP 210(f).
- jj. Allow the use of prior sworn statements for any reason, and limit or expand the parties’ intended use of the same. RoP 235(a), (a)(5).

- kk. Express views on offers of settlement. RoP 240(c)(2).
- ll. Grant or deny leave to move for summary disposition. RoP 250(a).
- mm. Order that hearings not be recorded or transcribed. RoP 302(a).
- nn. Grant or deny the parties' proposed corrections to hearing transcript. RoP 302(c).
- oo. Issue protective orders governing confidentiality of documents. RoP 322.
- pp. Take "official notice" of facts not appearing in the record. RoP 323.
- qq. Regulate the scope of cross-examination. RoP 326.
- rr. Certify issues for interlocutory review, and determine whether proceedings should be stayed during pendency of review. RoP 400(c), (d).

***The SEC ALJ's Decision***

44. At the close of an administrative proceeding, the SEC ALJ issues his or her decision, referred to in the Rules of Practice as the "initial decision." RoP 360. The initial decision states the time period within which a petition for Commission review of the initial decision may be filed. The SEC ALJ exercises his or her discretion to decide that time period.

45. The initial decision becomes the final decision of the SEC after the period to petition for review expires, unless the Commission takes the SEC ALJ's decision up for review. With certain exceptions that do not apply to this matter, the Commission is not required to take up any SEC ALJ's decision for review.

46. As applied to this matter, Commission review is entirely discretionary. The Commission can deny a petition for review for any reason, after considering whether the petition for review makes a reasonable showing that (i) the decision embodies a clearly erroneous finding of material fact, an erroneous conclusion of law, or an exercise of discretion or decision of law or policy that is "important"; or (ii) a prejudicial error was committed during the proceeding.

47. If no party requests review, and if the Commission does not undertake review on its own initiative, no Commission review occurs. Instead, the Commission enters an order that the decision has become final, and “the action of [the] administrative law judge ... shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission.” 15 U.S.C. § 78d-l(c). The order of finality states the date on which sanctions imposed by the SEC ALJ, if any, will become effective. RoP 360(d)(2).

48. Nothing in the rules or statutes prevents the Commission from making the ALJ's sanction effective before the respondent has had an opportunity to appeal the Commission's order, and in fact the Commission routinely makes sanctions effective immediately. *See, e.g., In the Matter of Mark Andrew Singer*, Exchange Act Rel. No. 72996, 2014 SEC LEXIS 3139 (Sept. 4, 2014).

#### ***The Position of SEC ALJ***

49. The SEC is a “Department” of the Executive Branch of the U.S. Government. The individual Commissioners are the “heads” of the Department. *Free Enterprise*, 130 S. Ct. at 3163. The Commissioners appoint SEC ALJs.

50. The ALJ position is established by statute, which provides that each agency “shall” appoint as many ALJs as necessary for the agency's administrative proceedings. 5 U.S.C. § 3105.

51. The Administrative Procedure Act (“APA”), 5 U.S.C. § 500 et seq., establishes ALJs’ powers with respect to adjudication. 5 U.S.C. §§ 556, 557. The securities laws empower the SEC to delegate certain functions to SEC ALJs, including those listed above at paragraphs 42.a through 42.rr and 43 through 46. 15 U.S.C. §78d-l.



52. SEC regulation establishes the “Office of Administrative Law Judges,” and outlines their authority. *See, e.g.*, 17 C.F.R. § 200.14; 17 C.F.R. § 200.30-9; 17 C.F.R. § 201.111. Those regulations provide that SEC ALJs' authority with respect to adjudications is to be as broad as the APA allows. 17 C.F.R. § 201.111 (“No provision of these Rules of Practice shall be construed to limit the powers of the hearing officer provided by the Administrative Procedure Act, 5 U.S.C. 556, 557.”).

53. The salary of SEC ALJs is specified by statute. There are eight levels of basic pay for ALJ s, the lowest of which may not be less than 65% of the rate of basic pay for level IV of the Executive Schedule, and the highest of which may not be more than the rate of basic pay for level IV of the Executive Schedule. 5 U.S.C. § 5372. (The Executive Schedule is a system of salaries given to the highest-ranked appointed positions in the executive branch of the U.S. government. 5 U.S.C. § 5311.)

54. The means of appointing an ALJ is specified by statute. Appointments are made by agencies based on need. 5 U.S.C. § 3105. By regulation, ALJs may be appointed only from a list of eligible candidates provided by the Office of Personnel Management (“OPM”) or with prior approval of OPM. 5 C.F.R. § 930.204. OPM selects eligible candidates based on a competitive exam, which OPM develops and administers. The SEC, like other agencies, selects ALJs from OPM's list of eligible candidates, based on the SEC’s need. 5 U.S.C. § 3105; 5 C.F.R. § 930.204.

55. All ALJs receive career appointments and are exempt from probationary periods that apply to certain other government employees. 5 C.F.R. § 930.204(a). They do not serve time-limited terms.

56. SEC ALJs are “officers” of the United States due, among other things, to the significant authority they exercise; the broad discretion they are afforded; their career appointments; that they are appointed by the heads of an Executive Department; the statutory and regulatory requirements governing their duties, appointment, and salary; the statutory authority creating their position; and their power, in certain instances, to issue the final decision of the agency.

***Removal of SEC ALJs***

57. SEC ALJs are removable from their position by the SEC “only” for “good cause,” which must be “established and determined” by the Merit Systems Protection Board (“MSPB”). 5 U.S.C. § 7521(a).

58. This removal procedure involves two or more levels of tenure protection.

59. First, as noted, SEC ALJs are protected by statute from removal absent “good cause.” 5 U.S.C. § 7521(a).

60. Second, the SEC Commissioners, who exercise the power of removal, are themselves protected by tenure. They may not be removed by the President from their position except for “inefficiency, neglect of duty, or malfeasance in office.” *See, e.g., Free Enterprise*, 130 S. Ct. at 3148; *MFS Sec. Corp. v. SEC*, 380 F.3d 611, 619-20 (2d Cir. 2004).

61. Third, members of the MSPB, who determine whether sufficient “good cause” exists to remove an SEC ALJ, are also protected by tenure. They are removable by the President “only for inefficiency, neglect of duty, or malfeasance in office.” 5 U.S.C. § 1202(d).

**The SEC ALJs’ Removal Scheme Violates Article II’s Vesting of Executive Power in the President**

62. As executive officers, SEC ALJs may not be protected by more than one layer of tenure.

63. Article II of the U.S. Constitution vests “[t]he executive Power ... in a President of the United States of America,” who must “take Care that the Laws be faithfully executed.” U.S. Const. art. II, § 1, cl. 1; *id.*, § 3. In light of “[t]he impossibility that one man should be able to perform all the great business of the State,” the Constitution provides for executive officers to “assist the supreme Magistrate in discharging the duties of his trust.” 30 Writings of George Washington 334 (J. Fitzpatrick ed. 1939); *see also Free Enterprise*, 561 U.S. 477, 130 S. Ct. at 3146.

64. Article II's vesting authority requires that the principal and inferior officers of the Executive Branch be answerable to the President and not be separated from the President by attenuated chains of accountability. Specifically, as the Supreme Court held in *Free Enterprise*, Article II requires that executive officers, who exercise significant executive power, not be protected from being removed by their superiors at will, when those superiors are themselves protected from being removed by the President at will.

65. The SEC ALJs' removal scheme is contrary to this constitutional requirement because SEC ALJs are inferior officers for the purposes of Article II, Section 2 of the U.S. Constitution, and because:

- a. SEC ALJs are protected from removal by a statutory “good cause” standard; and
- b. The SEC Commissioners who are empowered to seek removal of SEC ALJs - within the constraints of the “good cause” standard – are themselves protected from removal by an “inefficiency, neglect of duty, or malfeasance in office” standard; and

- c. The MSPB members who are empowered to effectuate the removal decision - again limited by a “good cause” standard - are themselves protected from removal by an “inefficiency, neglect of duty, or malfeasance in office” standard.

66. Under this attenuated removal scheme, “the President cannot remove an officer who enjoys more than one level of good-cause protection, even if the President determines that the officer is neglecting his duties or discharging them improperly. That judgment is instead committed to another officer, who may or may not agree with the President's determination, and whom the President cannot remove simply because that officer disagrees with him. This contravenes the President’s ‘constitutional obligation to ensure the faithful execution of the laws.’” *Free Enterprise*, 130 S. Ct. at 3147 (quoting *Morrison v. Olson*, 487 U.S. 654, 693 (1988)).

67. Because the President cannot oversee SEC ALJs in accordance with Article II, SEC administrative proceedings violate the Constitution.

**The Commission’s Disparate and Unlawful Treatment of Mr. Peixoto**

68. The SEC is treating Mr. Peixoto differently from all other non-regulated persons, from whom it sought civil penalties for insider trading, in a litigated proceeding<sup>2</sup> since the passing of Dodd-Frank by depriving Mr. Peixoto of the most fundamental rights to suitably defend against the insider trading charges.

69. Since the July 2010 effective date of Dodd-Frank, which empowered the SEC to seek civil penalties against non-regulated persons in administrative proceedings, the SEC has filed every litigated insider trading case against non-regulated persons in district court, with only two exceptions. In the first exception, the SEC withdrew the administrative case after the

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<sup>2</sup> We distinguish between cases in which a defendant agrees to settle with the insider trading charges prior to the issuance of an OIP, resulting in an SEC Order Instituting Proceedings, Making Findings and Imposing Remedial Sanctions (“settled proceeding”), from those where the defendant litigates the charges (“litigated proceeding”).

defendant challenged the SEC's choice of forum in an action such as this one. In the second exception, the defendant settled the SEC's charges before the matter went to a hearing. **Critically, the remaining 156 non-regulated persons charged with insider trading and from whom the SEC sought civil penalties were all sued in district court.**

70. These 156 non-regulated persons against whom the SEC sought civil penalties on insider trading charges constitute a class of persons similarly situated to Mr. Peixoto. Yet, without any rational basis, the SEC singled out Mr. Peixoto. While the 156 similarly-situated persons were sued in district court—where they received a jury trial, broad discovery rights and the right to counterclaim—Mr. Peixoto received disparate treatment and was sued administratively, in a forum that significantly, if not unconstitutionally, curtails his ability to defend the charges against him, as explained below.

71. There is no rational basis for the SEC's disparate treatment of Mr. Peixoto. A review of the SEC's post-Dodd-Frank insider trading cases reveals that the legal theory of insider trading liability upon which the SEC charges are based ("classical theory" or "misappropriation theory") does not establish a basis for whether the matter against a non-regulated defendant was filed in district court instead of administratively. Indeed, as mentioned, all (but two) of the insider trading cases seeking civil penalties against non-regulated persons were filed in district court, regardless of the SEC's legal theory of insider trading liability.

72. Similarly, a defendant's citizenship does not explain the SEC's decision whether to file an insider trading case in district court. In fact, since Dodd-Frank, the SEC has brought approximately 11 insider trading cases against non-U.S. defendants, such as Mr. Peixoto, and filed them all in district court.

73. A review of the SEC's insider trading cases against the similarly-situated 156 non-regulated persons reveals virtually identical cases that the SEC filed in district court. A list of SEC post Dodd-Frank litigated insider trading cases is attached hereto and incorporated herein as Exhibit D. For example, in just the last two years, the SEC has charged four non-regulated persons in district court with insider trading in cases that are nearly identical to the case against Mr. Peixoto in terms of scope, complexity, legal theories involved, amounts of money at issue, categories of witnesses, violations alleged, and penalties sought. Indeed, one of the four non-regulated persons was a foreign citizen, like Mr. Peixoto. The similarity between the SEC allegations against the four other persons and against Mr. Peixoto is plainly apparent. A chart illustrating those similarities is attached hereto and incorporated herein as Exhibit E. These four cases are described below.

74. In *SEC v. Cedric Canas Maillard*, Civ. Action No. 13-cv-5299 (S.D.N.Y.), the SEC charged Julio Marin Ugedo ("Ugedo"), a non-regulated, Spanish citizen, with insider trading. Under facts strikingly similar to those alleged against Mr. Peixoto, the SEC's complaint alleged that Ugedo learned of a proposed corporate acquisition from a friend who was employed at an investment bank. The friend, in violation of a duty to his employer, misappropriated the information by providing it to Ugedo. The complaint further alleged that Ugedo committed insider trading by trading in anticipation of the acquisition, from which he profited in an amount of \$43,566. The SEC's complaint relied on the occurrence of certain phone calls and the transmission of text messages prior to Ugedo's trading. For these alleged violations, the SEC sought civil penalties from Ugedo in district court.

75. Similarly, in *SEC v. Walter D. Wagner*, Civ. Action No. 14-cv-01036-PJM (D. Md.), the SEC charged Alexander J. Osborn ("Osborn"), a non-regulated person, with insider

trading. The SEC alleged that Osborn learned of a future corporate acquisition from an investment banking friend. The friend, in violation of a duty to his employer, misappropriated the information by providing it to Osborn. Osborn allegedly committed insider trading by trading in anticipation of the acquisition, from which he profited in an amount of \$439,830. Much like in the case against Mr. Peixoto, the SEC's complaint relies upon the occurrence of phone calls between Osborn and his friend and the transmission of text messages prior to Osborn trading. The SEC sought civil penalties from Osborn, and did so in district court.

76. In *SEC v. Eric J. McPhail*, Civ. Action No. 14-cv-12958 (D. Mass.), the SEC charged, *inter alia*, Douglas A. Parigian ("Parigian") and Jamie A. Meadows ("Meadows"), two non-regulated persons, with insider trading, in district court. The complaint alleged that a friend (the "Misappropriator") of Parigian and Meadows provided them with certain material nonpublic information he had received in breach of a duty of trust he owed to his friend. Much like in the case against Mr. Peixoto, the scienter requirement against Parigian and Meadows depended upon the interpretation of certain written communications as between the co-defendants. The SEC sought civil penalties from Parigian and Meadows in district court.

77. Here, the SEC, without a legitimate purpose, singles out Mr. Peixoto and treats him differently than similarly-situated persons. The SEC seeks to try Mr. Peixoto administratively where he would be deprived of guaranteed application of the Federal Rules of Evidence, which preclude unreliable evidence, such as multiple layers of hearsay evidence that the SEC would seek to offer in an administrative proceeding. As a practical matter, the combination of multiple hearsay evidence offered by the SEC and constricted discovery for Mr. Peixoto lowers the burden for the SEC to prove its allegations.

78. Moreover, instead of having the claims determined by a jury, Mr. Peixoto faces an administrative proceeding where appellate review in the first instance is by the Commission itself, before any judicial review. Mr. Peixoto would be forced to meet an accelerated schedule that excludes depositions and other discovery essential to a defense against insider trading charges. The administrative proceeding—by denying the opportunity to conduct full discovery—hampers the ability to test and challenge the inferences to be drawn from conversations, phone records, text messages and Gmail chats—the very type of “evidence” on which insider trading cases, including this one, are based. This is precisely the prejudice suffered by Mr. Peixoto, as mentioned by the SEC’s General Counsel, and is contrary to the treatment afforded similarly situated persons.

79. As reviewed against the 156 insider trading cases brought by the SEC against non-regulated persons, there is no legitimate purpose for the SEC’s disparate treatment of Mr. Peixoto. Indeed, when asked by undersigned counsel, the SEC failed to provide even the most basic, legitimate purpose for filing the action against Mr. Peixoto administratively, rather than in district court. Given the overwhelming data of similarly situated persons and the SEC’s reticence, the only plausible inference is that the SEC is treating Mr. Peixoto differently for the bad faith purpose of disarming an adversary from defending against a flawed case.

#### **The Compelling Need for Judicial Review**

80. Mr. Peixoto has commenced this action in prompt response to the OIP, which affords him limited time to answer and to prepare for the administrative hearings and, as a practical matter, no viable administrative process to obtain a fair resolution of the constitutional issues implied in the OIP. In these circumstances, the Court should address the merits of this Complaint without requiring Mr. Peixoto to first challenge the order administratively.



81. More specifically, exhaustion of administrative remedies should be excused in this case because the government interests that might be served by exhaustion do not outweigh the interests to be served by immediate judicial review of the legal issues being presented. Mr. Peixoto has compelling need for immediate judicial review: He would be forced to expend time and money in an administrative appeal process—while his public image is being tarnished and his career prospects diminished—with no assurance that the administrative proceeding against him would be stayed by the Commission pending agency determination of the constitutional issues. The constitutionality of the SEC Administrative Law Judges is strictly a legal issue and Plaintiff's equal protection claim is entirely independent of the merits of the insider trading charges. As such, no factual development or application of agency expertise will aid the Court's decision of either of Plaintiff's claims. Nor will a decision by the Court invade the field of SEC expertise or discretion. The statutory interpretation and constitutional claim in this case are the type of issues that courts regularly address and are more expert in adjudicating than agencies.

82. Moreover, the futility of exhausting the administrative remedies in this case is evident by the various ongoing actions against the SEC echoing the sentiment of an inadequate SEC ALJ process and expending significant monies on seeking interlocutory appeals. These cases demonstrate that defendants' requests for review fall on deaf ears or that the SEC ALJ process and rules are ill-equipped for review of claims of this kind.

83. For example, in *In the Matter of Harding Advisory LLC and Wing F. Chau*, Admin. Proc. File No. 3-15574, respondents requested that the SEC ALJ issue an order: (1) extending time and granting a six-month adjournment; (2) providing that proceedings would be governed by certain Federal Rules of Civil Procedure; and (3) requiring the SEC Division of

Enforcement to provide or identify certain materials. After the ALJ denied that motion, respondents submitted an emergency motion requesting that the ALJ address the ongoing violations of respondents' equal protection and due process rights by reconsidering his order or staying the hearing and prehearing deadlines pending a petition for interlocutory review by the Commission. The ALJ denied that motion, attached hereto and incorporated herein as Exhibit F. **In fact, the ALJ stated that he was not sure that constitutional due process and equal protection issues were justiciable in the administrative process, and the ALJ did not allow the respondents to develop the record in that regard.** See Transcript of Proceedings at 9 (Docket Entry No. 6), *Harding Advisory LLC and Wing F. Chau v. SEC*, Civ. Action No. 14-cv-01903-LAK (S.D.N.Y.). Respondents then submitted a petition for interlocutory review of the ALJ's orders, attached hereto and incorporated herein as Exhibit G. On March 14, 2014, the Commission issued its Order Denying Petition, attached hereto and incorporated herein as Exhibit H. See Complaint at ¶51 (Docket Entry No. 2), *Harding Advisory LLC and Wing F. Chau v. SEC*, Civ. Action No. 14-cv-01903-LAK (S.D.N.Y.).

84. The ALJs and the Commission have thereby demonstrated that the SEC administrative proceeding is not a forum in which a defendant's equal protection and other constitutional claims can be heard. The ALJs and the Commission have thereby also demonstrated that the procedural protections afforded to similarly situated defendants are not available in a SEC administrative proceeding. It would be futile for Mr. Peixoto to repeat these efforts and expect different results.

**The SEC's Chosen Course Will Cause Mr. Peixoto Severe and Irreparable Harm**

85. Without injunctive relief from this Court, Mr. Peixoto will be required to submit to an unconstitutional proceeding and a situation where the Commission has intentionally and

specifically, in purpose and effect, deprived him of his rights of equal protection under the law. The violation of a constitutional right, standing alone, constitutes irreparable injury. The lack of traditional procedural safeguards in SEC administrative proceedings further exacerbates that harm.

86. Allowing the SEC to pursue an administrative proceeding while the instant complaint is pending would require the expenditure of substantial legal fees defending against an unconstitutional action. Moreover, Mr. Peixoto cannot assert counterclaims or seek declaratory relief in an administrative proceeding, foreclosing any possibility of review until an appeal to a federal circuit court of appeals. *See In the Matter of Jeffrey L. Feldman*, Admin. Proc. File No. 3-8063, 1994 SEC LEXIS 186, at \*4-5 (Jan. 14, 1994), attached hereto and incorporated herein as Exhibit I. The burdens incurred during an administrative proceeding would be for naught. Forcing Mr. Peixoto to litigate parallel proceedings would compound costs and reputational risk.

87. Furthermore, if Mr. Peixoto were to lose in an administrative proceeding, the damage could be severe and irreversible, well before Mr. Peixoto could obtain meaningful judicial review of the Article II and equal protection claims.

88. This severe harm, which threatens to damage Mr. Peixoto's candidacy as an applicant in finance and business is irreparable. The availability of an appeal to an administrative proceeding to a federal circuit court of appeals cannot avoid it, because the administratively-imposed sanction already may take effect – and the damage therefore already substantially and harmfully done – by the time the appellate court made a ruling.

89. Likewise, the harm cannot be remedied after the fact by money damages. Various immunity doctrines substantially constrain Mr. Peixoto's ability to seek damages from the SEC. Furthermore, even if damages were procedurally available, the reputational harm to Mr. Peixoto

– permanent and devastating to his business school effort and his career and life thereafter – should the SEC impose administrative sanctions would be impossible to monetize. Calculating the value of the damage to his life and career, including lost opportunities that would result from an unfavorable ruling in an unconstitutional administrative proceeding would be well-nigh impossible.

90. By contrast, the SEC will suffer no harm from a pause in an administrative proceeding against Mr. Peixoto pending final resolution of these important constitutional issues. Any claim of harm by the SEC would be particularly fanciful because the SEC maintains the option of bringing its enforcement action against Mr. Peixoto in federal court, as it routinely does with other non-regulated persons charged with insider trading. Moreover, this is not a case where investors would be adversely affected by injunctive relief from this Court.

**COUNT ONE**  
**APPLICATION FOR INJUNCTIVE RELIEF**

91. Mr. Peixoto repeats and re-alleges paragraphs 1 - 90 as if set forth in full.

92. Mr. Peixoto's constitutional rights will be irreparably harmed if a permanent injunction (and, if necessary, a preliminary injunction and temporary restraining order) are not issued against the SEC's administrative proceeding. Mr. Peixoto has a substantial likelihood of success on the merits of his claim. Mr. Peixoto will be irreparably injured without injunctive relief, as described above, and the harm to Mr. Peixoto, absent injunctive relief, far outweighs any harm to the SEC if they are granted. Finally, the grant of an injunction will serve the public interest in the protection of Mr. Peixoto's constitutional rights.

**COUNT TWO**  
**DECLARATORY JUDGMENT**

93. Mr. Peixoto repeats and re-alleges paragraph 1 - 92 as if set forth in full.

94. Mr. Peixoto requests a declaratory judgment that the statutory and regulatory provisions providing for the position and tenure protections of SEC ALJs are unconstitutional.

95. Mr. Peixoto also requests a declaratory judgment that (i) the Commission's decision to initiate and pursue administrative proceedings against Mr. Peixoto violated and is violating his right to equal protection under the law, and the (ii) the Commission violated and is violating Mr. Peixoto's right to due process.

**JURY DEMAND**

96. Mr. Peixoto hereby demands a trial by jury on all issues so triable.

WHEREFORE, Mr. Peixoto's prayer for judgment and relief are as follows:

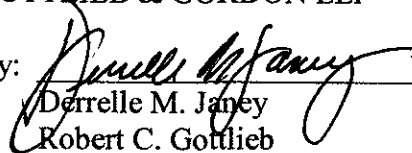
- (a) A declaration that (i) the Commission's decision to initiate and pursue administrative proceedings against Mr. Peixoto violated and is violating his right to equal protection under the law, and (ii) the Commission violated and is violating Mr. Peixoto's right to due process.
- (b) A declaration that the statutory and regulatory provisions providing for the position and tenure protections of SEC ALJs are unconstitutional.
- (c) A permanent injunction, enjoining the Commission from pursuing its OIP against Mr. Peixoto administratively.
- (d) Such other and further relief as this Court may deem just and proper, including reasonable attorneys' fees and the costs of this action.

Dated: October 20, 2014  
New York, NY

Respectfully submitted,

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