

SEC Actions Against Musk Are Constitutionally Defective

By **Alex Lipman and Justin Weddle** (October 13, 2023, 6:50 PM EDT)

The U.S. Securities and Exchange Commission's Oct. 6 subpoena enforcement action against Elon Musk is the latest punch in the long-running sparring match between the two parties.

The SEC filed its action against Musk for refusing to comply with the agency's subpoenas in a manner that is satisfactory to the SEC staff investigating his purchase of Twitter Inc., now X.

Musk's counsel is resisting the SEC subpoena for several reasons — the main one, it seems, being that Musk's lawyers think that he has adequately complied with the SEC's demands for information and that, therefore, enough is enough.

Legal commentators have reacted to the SEC's enforcement action in a somewhat predictable manner, stressing that the SEC has broad investigative authority, and that Musk's resistance to the SEC subpoenas is therefore unlikely to succeed.

But if the subpoenas to Musk were issued in a manner consistent with the SEC Enforcement Division's usual process for issuing subpoenas, those subpoenas may be void, because they do not comport with constitutional requirements. Indeed, even if the commission itself, and not its staff, issued those subpoenas, the subpoenas are likely unenforceable.

In short: Just as SEC administrative law judges are officers of the U.S. who wield the power of the executive when they hear SEC enforcement cases in SEC in-house proceedings, so are SEC enforcement staff officers of the U.S. — because they too wield executive power when they conduct investigations by, among other things, issuing subpoenas to compel production of documents and witness testimony.

And lest there be any doubt that SEC staff wielded executive power when they subpoenaed Musk, the SEC staffer who issued the relevant subpoena invoked that power by representing — on the face of the subpoena — that he was an officer of the SEC authorized to issue the subpoena.[1]

As officers of the U.S., just like the SEC ALJs, these SEC staffers must be properly appointed in accordance with constitutional requirements. They most likely are not. They are inferior officers who may be appointed only by the president, courts of law or heads of departments.[2]



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The commission has delegated the power to open formal investigations, and designate and empower officers to conduct those investigations, to the director of the Enforcement Division.[3] The director of enforcement is not mentioned in the Constitution, and he is not the head of a department. Thus, he cannot appoint officers.

Therefore, if the director of enforcement, or someone reporting to him, issued the formal orders for In the Matter of Certain Purchases, Sales, and Disclosures of Twitter Shares, the appointments of the relevant staffers who are conducting that investigation are invalid.

The actions of those staffers, including the subpoenas they sent out, are thus void. To make matters worse, the staffers enjoy multiple layers of good-cause protection from removal by the president — which, at a minimum, may render their subpoenas unenforceable, according to the logic of the relevant U.S. Supreme Court precedent.

In addition, the government asserted in *Seila Law LLC v. Consumer Financial Protection Bureau*, a 2020 Supreme Court case, that the CFPB director was shielded from removal by the president except for good cause, which may render subpoenas issued by it, or its staff, unenforceable.[4]

The SEC's action affords Musk an opportunity to strike a knockout punch — to challenge the formal orders and the subpoenas as unconstitutional, and, in so doing, effect pro-democratic change to the manner in which the SEC is structured and conducts investigations.

The SEC's processes, formal orders and subpoenas are unconstitutional, and serve to hide the SEC's aggressive actions behind a nameless and faceless bureaucracy, instead of what the Constitution requires — a clear chain of command and accountability for significant exercises of U.S. executive power.

Constitutional and Congressional Requirements

The Constitution, and the SEC's authorization from Congress to conduct investigations, require that such investigations be conducted by properly appointed officers.

As the Supreme Court explained in *Seila Law LLC v. Consumer Financial Protection Bureau* in 2020, the power of inferior officers to enforce federal law on behalf of the U.S. is derived from the president's executive power.[5] SEC enforcement staff wield that executive power, and discharge officer functions, when they initiate and conduct investigations, as well as when they prosecute subpoena enforcement actions like the one against Musk.[6]

It follows that this power can only be wielded by officers who hold proper appointments.[7] Reflecting this reality, Congress was sure to require in the relevant enabling provisions of the federal securities laws that those laws be enforced exclusively by officers.

The authorizing statutory provisions under which SEC formal orders are issued — e.g., Section 19(c) of the Securities Act and Section 21(b) of the Securities Exchange Act — require investigations to be conducted either by one of the commissioners, or by an inferior officer designated by the commission for that purpose.[8] Note that the grouping of the commissioners with other officers in the authorizing language implies a parity of authority.

The use of the term "officer," in other words, reflects congressional intent and appreciation that those

conducting SEC investigations were imbued with — to quote the Supreme Court's 2010 opinion in *Free Enterprise Fund v. Public Company Accounting Oversight Board* — "significant authority pursuant to the laws of the United States." [9]

Note, too, that by empowering inferior officers to seek evidence that "the Commission deems relevant or material to the inquiry," [10] the authorizing provisions delegate to designated officers a portion of the commission's power, as well as its discretion.

The SEC's Understanding of Constitutional and Congressional Mandates

The SEC appears to recognize that its formal orders empower staff to wield executive power. Here is how the SEC explains, in relevant part, the purpose of a formal order in its Enforcement Manual:

[I]t designates specific staff members to act as officers for the purposes of the investigation and empowers them to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of documents and other materials. Formal investigative proceedings are nonpublic unless otherwise ordered by the Commission. [11]

A formal order is, by the SEC's own admission, therefore, the instrument by which the SEC empowers its staff to perform officer functions on its behalf, and conduct a proceeding. Undoubtedly, in the investigation involving Musk, after reciting the relevant authorizing statutory provisions, the relevant formal orders stated, as they always do, that:

[The listed individuals] are hereby designated as officers of the Commission and are empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of ... records deemed relevant or material to the inquiry, and to perform all other duties in connection therewith as prescribed by law.

This means that either:

- The listed staffers must be individuals who have already been appointed as officers by the commission itself, who are then tasked by the formal order with conducting a specific investigation — a reading most consonant with the plain language of the authorizing provisions' use of the word "designated"; or
- The formal order is the instrument by which staffers are appointed as officers so that they can exercise the power and discretion of the executive, or — in the words of the Enforcement Manual — act as officers.

In either case, the apparent purpose of the formal order is to authorize staff to perform officer functions in connection with a proceeding. Indeed, if what the staff do in conducting investigations is not exercising executive power, they have no need to have some portion of that power delegated to them.

Formal Order Designations or Appointments Likely Null and Void

Unless properly appointed, the SEC staff in Musk's case are exercising power they do not lawfully possess. [12]

As noted, commission personnel carrying out officer responsibilities must be properly appointed as officers by the commission reporting to the president. [13] But the commission likely did not appoint

them, and the director of enforcement does not have the power to appoint inferior officers.

The formal order's purported appointment is, therefore, a nullity. All actions by officers who are not properly appointed are void.[14]

Subpoenas Cannot Be Enforced

Even if there is no appointment defect relating to the staff designation in the formal orders, there still is a constitutional defect that results from the way the SEC is structured — removal protections of SEC commissioners and personnel violated the president's removal powers under the Constitution.

Under Article II of the Constitution, the entirety of the executive power is vested in the president.[15] The president's executive power includes appointing, overseeing and controlling officers of the U.S. who wield that power.[16]

This includes the ability to remove such officers on an unrestricted basis, as shown by historical precedent.[17] If the coercive power of the executive is devolved to an executive agency or department, the head of that agency or department must be removable at will for the structure to be constitutional.[18]

For constitutional purposes, the SEC is a department.[19] It wields executive power.[20] The commission must therefore be removable by the president at will.[21] In *Free Enterprise*, however, the government claimed that the commission is not so removable.[22]

Rather, according to the government in *Free Enterprise Fund*, SEC commissioners cannot be removed except for "inefficiency, neglect of duty, or malfeasance in office." [23] The manner of the delegation of the executive power to the SEC, through the commission as its head, is therefore unconstitutional, as it was with respect to the head of the CFPB in *Seila Law*.

Two things follow. One, the subpoena enforcement action against Musk must be dismissed as improperly authorized because it was filed by an agency that was not under proper presidential control, in violation of the Constitution.[24] Two, until any impediments to the president's removal power of all the commissioners are removed, the SEC cannot continue to prosecute its efforts to enforce subpoenas.[25]

Finally, even if the relevant SEC staff were properly appointed, another independent reason that their actions may be improper — as is the prosecution of the subpoena enforcement case — is that like the commissioners themselves, regular SEC staff cannot be removed at will.[26] Therefore, the consequences that flow from that defect apply to the staff.

Indeed, the problem is even worse, because the SEC staff enjoy at least two layers of good-cause protection from the president. As the Supreme Court ruled in *Free Enterprise Fund*, in order to maintain proper oversight by the president, ensure political accountability and avoid diffusion of executive power, inferior officers who exercise significant executive power cannot be separated from the president by multiple layers of good-cause protection from removal.[27]

Possible Challenges to the SEC's Unconstitutional Enforcement Processes

Up until now, Musk's arguments have appealed to fairness — essentially arguing that enough is enough,

and that the SEC is harassing him. Perhaps this latest enforcement action will prompt him to hit back by questioning the very constitutionality of the SEC's processes, and the validity of its subpoenas.

After all, he could just as easily complain about an unaccountable, nameless bureaucracy as the harassment that seems to be its symptom, and he could fairly call on an agency charged with enforcing the law to first itself follow the law, including the supreme law of the land: the Constitution.

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[1] In addition, typically, SEC staff open every investigative testimony session by representing that they are officers of the commission for purposes of the investigation they are conducting, and that a copy of the formal order that authorizes them to conduct the investigation is available throughout the testimony for the witness's reference.

[2] U.S. Const., Art. 2, Sec. 2, Clause 2.

[3] See 17 CFR § 200.30-4 (a)(1) and (13).

[4] Cf. *Seila Law LLC v. CFPB*, 140 S. Ct. 2183 (2020) (a civil investigative demand issued by an agency led by a principal officer not removable at will by the president cannot be enforced).

[5] See *id.* at 2197.

[6] See *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 485-86 (2010).

[7] *Seila Law*, 140 S. Ct. at 2197.

[8] See 15 U.S.C. §77s(c) ("For the purpose of any such investigation, or any other proceeding under this chapter, any member of the Commission or any officer designated by it is empowered"); 15 U.S.C. § 78u(b) (substantively same).

[9] *Free Enterprise Fund*, 561 U.S. at 486 (quoting *Buckley v. Valeo*, 424 U.S. 1, 25–26 (1976)).

[10] 15 U.S.C. §78u(b); 15 U.S.C. §77s(c) (same).

[11] SEC Enforcement Manual, Section 2.3.4.

[12] *Collins v. Yellen*, 141 S. Ct. 1761, 1788 (2021). The SEC has not filed publicly the formal order relating to Musk, or the subsequent corrected formal order, so it is unclear whether those documents' designation of officers is the claimed source of authority to issue subpoenas, and whether that source of authority comports with the Constitution. The SEC's claim that it has not filed these documents publicly because the investigation is private might please Humpty Dumpty, but it is a particularly inapt way to

describe the very public, long-running investigation and feud between the SEC and Musk. See Lewis Carroll, *Through the Looking Glass, and What Alice Found There* 124 (MacMillan & Co. 1875) ("When I use a word, 'Humpty Dumpty said in a rather scornful tone, 'it means just what I choose it to mean—neither more nor less'").

[13] See, e.g., *Lucia v. SEC*, 138 S. Ct. 2044, 2051 (2018).

[14] See *id.* at 2055 (a party who makes a timely appointments clause challenge is "entitled to relief," including a redo of the proceeding before a properly appointed officer).

[15] *Seila Law*, 140 S. Ct. at 2191.

[16] *Id.* at 2197.

[17] *Id.* at 2197-98.

[18] *Id.* (invalidating actions of head of CFPB because of restrictions on removal).

[19] See *Free Enterprise Fund*, 561 U.S. at 511-13.

[20] See *Seila Law*, 140 S. Ct. at 2200 (authority to seek daunting monetary penalties against private parties on behalf of the U.S. is a quintessential executive power); see also *Free Enterprise Fund*, 561 U.S. at 485-86 (noting parties' agreement that members of PCAOB are officers of the U.S. for constitutional purposes, despite statutory provisions specifying that they are not government officials at all, because they can initiate "formal investigations and disciplinary proceedings").

[21] *Seila Law*, 140 S. Ct. at 2200.

[22] See *Free Enterprise Fund*, 561 U.S. at 487.

[23] *Id.*

[24] See generally *Seila Law*, 140 S. Ct. at 2183 (a civil investigative demand issued by a principal officer not removable at will by the president cannot be enforced).

[25] *Id.*; see also *Free Enterprise Fund*, 561 U.S. at 513 (parties facing government enforcement efforts are entitled to "relief sufficient to ensure that [the enforcement efforts] to which they are subject will be enforced by a constitutional agency accountable to the Executive").

[26] 5 U.S.C. § 4802 requires the SEC to comply with the merit system principles, which, in turn, provide various protections against removal at will to all its employees, including the director of enforcement. See generally 5 U.S.C. §§ 2301-2302. In addition, SEC staff are protected by a collective bargaining agreement between their union and the commission. See <https://www.secunion.org/collective-bargaining-agreement-nteu-chapter-293-authorized-version>.

[27] See *Free Enterprise Fund*, 561 U.S. at 483.