

The Scope Of SEC Defendants' Jury Trial Right: Part 2

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This is the second of four articles examining the scope of the Seventh Amendment jury trial right for civil defendants in U.S. Securities and Exchange Commission enforcement actions. The previous article explained why the Seventh Amendment entitles a civil defendant to a jury finding as to those facts that increase the maximum penalty — the “liability”— to which a defendant is exposed.[1] In that way, the right to a civil jury trial mirrors the criminal jury trial right.[2] In this article, we consider how this Seventh Amendment right applies to the determination of the number of violations a defendant committed and thus the number of violations for which the defendant may be liable.

“Each Violation” for Which Penalties are Imposed Under the Federal Securities Laws Must Be Found By a Jury

It was only in 1990 that Congress first authorized the SEC to seek civil monetary penalties for all federal securities law violations. The SEC may now seek increasingly severe penalties for “each violation.”[3] The base penalty for a violation by a natural person is \$5,000 (\$50,000 for a corporation or other entity). If the violation involved fraud or deceit, the maximum penalty increases to \$50,000 (\$250,000 for a corporation or other entity). And if the violation involved fraud and resulted in substantial losses or a significant risk of substantial losses to others, the maximum penalty increases to \$100,000 (\$500,000 for a corporation or other entity). For each penalty tier, the maximum penalty is increased to the gross amount gained if the defendant receives pecuniary gain as a result of the violation.[4] But any penalty under this three-tier system depends on an initial finding of a securities law violation. And each subsequent violation subjects a defendant to an additional penalty. In other words, liability under the federal securities laws is on a per-violation basis.

In the context of administrative proceedings, it is clear that imposition of a penalty requires that the fact finder determine the number of violations committed by the defendant.[5] That determination must be made separately for each defendant. In other words, a general finding that a violation occurred does not mean that each defendant in a multid defendant case is liable for that violation, nor does it establish the number of violations by a particular defendant. When the SEC proceeds against a defendant in federal court, the question becomes which fact finder must make the determination of how many violations can be attributed to each defendant. We believe that the Seventh Amendment, as interpreted in *Tull v. United States*, requires that the jury, not the judge, determine how many violations each defendant committed and consequently the number of penalties for which each defendant is liable.

Tull provides that a defendant “has a constitutional right to a jury trial to determine his liability on ... legal claims.”[6] Whether a defendant has committed a violation and is thus subject to any penalty at all surely is included in that “liability” determination. Indeed, the very definition of liability is “the state of being legally responsible for something ... such as the



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payment of money.”[7] A defendant is liable for a penalty only if he is found to have committed a violation. And a defendant is liable for a second penalty only if he is found to have committed a second violation. Thus, the jury must determine the number of violations each defendant committed before a judge may impose a penalty beyond the statutory penalty amount for a single violation. It would be incredible to suggest that, once the jury finds that a single violation occurred, the judge is allowed to decide on her own how many violations a defendant committed for purposes of deciding how many penalties to impose. Yet the SEC has convinced some courts to do just that.[8]

In the criminal context, the U.S. Supreme Court has easily concluded that the Sixth Amendment jury trial right entitles a defendant to a jury finding as to how many violations a defendant committed. The court rejected, for example, the government’s contention that the number of days a violation took place, which determined the maximum penalty, was simply a method of “quantifying the harm” caused.[9] The court instead held that, for each day it seeks a penalty, “the Government [must] prove[] that [the defendant] committed all of the acts constituting the offense.”[10] In other words, the government had to prove to the jury that the defendant committed the violation each day. Similarly, the SEC must, under the Seventh Amendment, prove the number of violations that a particular defendant committed, at least to the extent the commission seeks more than one penalty.

How Should Courts Define a “Violation” Under the Federal Securities Laws?

Once it is recognized that a defendant has the right to a jury determination of the number of violations committed, the next question is how to define a “violation” under the federal securities laws. Stated another way, what is the appropriate “unit” of violation? Section 10(b) of the Securities Exchange Act of 1934 (and Rule 10b-5 thereunder), for example, prohibits fraud and manipulation in connection with the purchase or sale of securities through the use of instrumentalities of interstate commerce.[11] Is the violation the entire scheme to defraud each fraudulent misrepresentation, each purchase or sale of securities, or each use of an instrumentality of interstate commerce? Judges have provided a variety of answers to that question.[12]

Other federal securities laws present similar problems. Section 15(a) of the Exchange Act makes it unlawful for a broker or dealer not registered with the SEC to use an instrumentality of interstate commerce to effect a transaction in securities.[13] Is the violation the failure to register or each securities transaction? Section 17(a)(3) of the Securities Act of 1933 makes it unlawful “to engage in any transaction, practice, or course of business” that operates as a fraud or deceit in the offer or sale of securities.[14] Is the violation the offer or sale of securities, or engaging in a practice or course of business that operates as a fraud or deceit? Courts need to resolve these questions so they can properly instruct juries on how to determine the number of violations committed by a defendant.

How courts define the unit of violation for purposes of the various securities law statutes could have significant practical implications for defendants in SEC enforcement actions. If a violation is defined as each sale of securities, then to obtain third-tier penalties the commission must prove that each distinct sale resulted in substantial losses. This could be difficult for pump-and-dump penny stock schemes, where the amount of loss from each purchase or sale is small. If instead the violation is the entire scheme to defraud, then the commission could obtain a third-tier penalty (if it proves significant

losses), but it could obtain only one such penalty. The unit of violation will thus determine whether a defendant must pay a single third-tier penalty of up to \$100,000 or multiple \$5,000 penalties.

The Rule of Lenity Supports a Narrow Interpretation of Violation

The rule of lenity suggests that any ambiguity regarding the unit of violation for a federal securities law violation should be resolved in favor of the defendant. The Supreme Court has held that when a statute is ambiguous as to the unit of prosecution, “ambiguity should be resolved in favor of lenity.”^[15] Although the rule of lenity was developed as a canon of construction in criminal cases, the rule also applies when interpreting statutes that have both criminal and civil applications.^[16] The language of a single statute cannot have different meanings depending on whether the violation is prosecuted by a criminal or a civil authority.^[17] Because every provision of the federal securities laws may be pursued civilly by the SEC and criminally by the U.S. Department of Justice, the rule of lenity should apply when interpreting these statutes regardless of the context.^[18] And while it is not immediately clear which unit of violation will always be more defendant-friendly, it is likely that a defendant in either a criminal prosecution or in an SEC enforcement action would be better off with a single violation (and thus a single penalty), rather than multiple ones.

Conclusion

The federal securities laws provide for penalties on a per-violation basis. The Seventh Amendment guarantees a defendant in an SEC enforcement action the right to have a jury determine the issue of liability. Accordingly, whether that defendant committed one or more violations and thus is liable for one or more penalties must be determined by the jury, not the judge. It is only after the jury finds how many violations each defendant committed that the judge can determine the appropriate penalty for those violations. Determining the number of violations is complicated, however, by the varied definitions of “violation” provided by the federal courts and administrative law judges. The rule of lenity suggests that the federal securities laws should be interpreted in favor of exposing a defendant to a single violation and thus a single penalty. But many of these questions have yet to be litigated. Thus, defendants in SEC enforcement actions should press these issues at all stages of the litigation and, in particular, during the jury charge conference.

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[1] See Matthew T. Martens, Jaclyn N. Moyer, and Derek A. Woodman, *The Scope of SEC Defendants’ Jury Trial Right:*

Part 1, *Law360* (July 1, 2016), <https://www.law360.com/articles/809309/the-scope-of-sec-defendants-jury-trial-right-part-1>. A more comprehensive analysis of these issues can be found at Matthew T. Martens & Troy A. Paredes, *The Scope of the Jury Trial Right in SEC Enforcement Actions*, 71 *N.Y.U. Ann. Surv. Am. L.* 147 (2016).

[2] See *Apprendi v. New Jersey*, 530 U.S. 466, 490 (2000).

[3] 15 U.S.C. §§ 77t(d), 78u(d), 80a-41(e), 80b-9(e).

[4] Each of these penalty tier amounts may be adjusted periodically by SEC regulations. See 28 U.S.C. § 2461 note. As of March 5, 2013, the penalties for natural persons under the three tiers are \$7,500, \$80,000, and \$160,000, respectively, and the penalties for corporations or other entities are \$80,000, \$400,000, and \$775,000. See 17 C.F.R. § 201.1005. On August 1, 2016, those amounts increase to \$8,908, \$89,078, and \$178,156 for natural persons and \$89,078, \$445,390, and \$890,780 for corporations or other entities. See *Adjustments to Civil Monetary Penalty Amounts*, 81 *Fed. Reg.* 43,042 (proposed July 1, 2016) (to be codified at 17 C.F.R. pt. 201).

[5] See *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012). In *Rapoport*, the D.C. Circuit held that, to impose penalties, “the Commission must determine how many violations occurred and how many violations are attributable to each [defendant], as the statute instructs.” *Id.* The SEC did not prove to the ALJ the number of violations it believed the defendants had committed. Instead, the ALJ was left to “parse up the violations” and determine “whether to treat the entire course of conduct as a single act or as a series of acts, as to which multiple penalties would be appropriate.” *Id.* The ALJ ultimately imposed the maximum second-tier penalty on each defendant five times—once for each year the alleged violations occurred. But because the SEC failed to prove how many violations each defendant committed, the Second Circuit vacated the ALJ’s decision.

[6] *Tull v. United States*, 481 U.S. 412,425 (1987).

[7] *Liability*, Merriam-Webster, <http://www.merriam-webster.com/dictionary/liability> (last visited July 5, 2016).

[8] See *SEC v. iShopnomarkup.com Inc.*, 126 F. Supp. 3d 318, 333 (E.D.N.Y. Sept. 3, 2015) (deciding to treat defendant’s conduct as three violations after jury returned a general verdict finding defendant violated federal securities laws). But see *SEC v. Schooler*, No. 3:12-cv-2164-GPC-JMA, 2015 WL 3491903, at *11 n.6 (S.D. Cal. June 3, 2015) (“[T]he Court believes it appropriate to submit the materiality and intent of the other alleged misrepresentations and omissions to the finder of fact to determine whether Defendants did, in fact, commit any other violations.”).

[9] *S. Union Co. v. United States*, 132 S Ct. 2344, 2356 (2012).

[10] *Id.*

[11] See 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

[12] See *United States v. Stitsky*, 536 F. App'x 98, 104 (2d Cir. 2013) (holding that “transactions in separate securities constitute separate offenses”), cert. denied, 135 S. Ct. 188 (2014); *United States v. Haddy*, 134 F.3d 542, 549 (3d Cir. 1998) (rejecting notion that appropriate unit of prosecution for securities fraud was each individual purchase or sale); *United States v. Langford*, 946 F.2d 798, 803 (11th Cir. 1991) (holding that “[t]he allowable unit of prosecution under section 78j(b) is ... the use of a manipulative device or contrivance, which, as clarified by the SEC in Rule 10b-5, does not have to be the complete scheme to defraud; rather, it can be any false statement of material fact in connection with a discrete purchase or sale of a security”); see also Jonathan Eisenberg, *How SEC Judges Calculate Civil Money Penalties*, *Law360* (Jan. 22, 2016), <https://www.law360.com/articles/749200/how-sec-judges-calculate-civil-money-penalties>.

[13] 15 U.S.C. § 78o(a)(1).

[14] *Id.* § 77q(a)

[15] *Bell v. United States*, 349 U.S. 81, 83 (1955).

[16] See *Leocal v. Ashcroft*, 543 U.S. 1, 11 n.8 (2004).

[17] See *Carter v. Welles-Bowen Realty Inc.*, 736 F.3d 722, 727 (6th Cir. 2013) (“A single statute with civil and criminal applications receives a single interpretation.”).

[18] See *Whitman v. United States*, 135 S. Ct. 352, 353-54 (2014) (Mem.) (Scalia, J., statement respecting the denial of certiorari) (arguing that the rule of lenity, rather than Chevron deference, should govern the interpretation of the federal securities laws).