

The Scope Of SEC Defendants' Jury Trial Right: Part 1

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It has been settled law for some time now that the Seventh Amendment right to a jury trial in U.S. Securities and Exchange Commission enforcement actions extends to liability determinations. Unsettled is the question of whether an individual has a right to a jury determination of the facts that set the maximum penalty to which a defendant is exposed under the SEC's three-tier system. Indeed, that question has not really been tested.[1] The question is significant to defendants in SEC enforcement actions because the factual findings necessary to prove that a violation has occurred and those necessary to set the maximum penalty that may be imposed are not always, or even often, the same.

This is the first in a series of four articles to explore the scope of a defendant's jury trial right in an SEC enforcement action seeking monetary penalties. In this article, we explain why the Seventh Amendment entitles defendants in SEC enforcement actions brought in federal district court to jury findings with respect to all facts that set the maximum monetary penalty the judge may impose.

In subsequent articles, we consider the application of this principle to proof of (1) the number of "violations," (2) whether a defendant's conduct resulted in any gain or loss and the amount of such gain or loss; and (3) the mental state required to obtain second- or third-tier penalties for otherwise negligence-based or strict liability securities law violations.[2]

The Framework for Calculating Civil Penalties Under the Federal Securities Laws

The SEC has the authority to seek civil monetary penalties for all securities law violations. But that authority is fairly new relative to the history of the SEC. Though the SEC was established in 1934, it first obtained civil penalty authority 50 years later under the Insider Trading Sanctions Act of 1984. It was only in 1990 that Congress expanded that power and authorized the SEC to seek civil monetary penalties for all federal securities law violations.[3] And the SEC has only recently decided to push the outer bounds of its legal authority under those penalty provisions. For these reasons, many of the SEC's enforcement practices with regard to penalties have not yet been challenged in litigation.

The federal securities laws authorize a district court to impose a civil monetary penalty for "each violation." [4] Although these statutes provide that "[t]he amount of the penalty shall be determined by the court in light of the facts and circumstances," the maximum statutory penalties that a district court may impose depend on the presence of additional facts beyond the elements of the violation.[5] Specifically, the statutes provide for three penalty tiers. The base penalty for any 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 loss or a significant risk of such loss 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



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amount gained by the defendant, if any, “as a result of the violation.”[6]

Determining Liability and Civil Penalty Amounts Historically

The penalty framework in SEC enforcement actions implicates the Seventh Amendment jury trial right. In *Tull v. United States*,^[7] the Supreme Court held that, in a government enforcement action seeking monetary penalties, a defendant has a Seventh Amendment right to a jury trial to determine the issue of liability, though a judge may decide the actual penalty imposed. At issue in *Tull* was an enforcement action under the Clean Water Act, which provided for “a civil penalty not to exceed \$10,000 per day.”^[8] The court explained that civil penalties under the CWA were the “type of remedy at common law that could only be enforced in courts of law” because they were remedies “intended to punish culpable individuals, as opposed to those intended simply to extract compensation or restore the status quo.”^[9] Thus, the defendant had “a constitutional right to a jury trial to determine his liability on the legal claims.”^[10] The court then relied on legislative history to decide “that Congress intended that trial judges perform the highly discretionary calculations necessary to award civil penalties after liability is found.”^[11] Because the CWA civil penalties were a creation of Congress, the court held that the Seventh Amendment allowed Congress to assign the authority to determine the appropriate penalty to judges. But the question of liability for a penalty was one for the jury.

More recently, the Supreme Court has reaffirmed that “the Seventh Amendment grants a right to a jury trial on all issues relating to liability for civil penalties.”^[12] At the same time, the court suggested that the portion of the *Tull* opinion stating that the jury trial right does not extend to a determination of the amount of the penalty to be imposed may have been dicta.^[13] In any event, the court explained that *Tull*’s disparate treatment of the liability determination and the penalty amount was founded, at least in part, on the notion that “the awarding of civil penalties to the Government could be viewed as analogous to sentencing in a criminal proceeding.”^[14]

As we approach the 30th anniversary of *Tull*, it is still unclear what findings are encompassed within a defendant’s right to a jury determination of “liability.” Courts have offered little guidance for what the jury must find before the judge may impose a particular penalty, largely because defendants have not challenged the court’s authority to find facts supporting an enhanced penalty. In enforcement actions, the SEC has generally assumed, without opposition, that the judge can make the factual findings necessary to invoke a higher penalty tier once the jury finds the defendant guilty of a securities violation. As discussed below, this is almost certainly incorrect. Liability under the Seventh Amendment cannot be determined without reference to the maximum sanction allowed by statute. Indeed, the very definition of liability is “the state of being legally responsible for something ... such as the payment of money.”^[15]

Facts That Increase the Penalty Tier Should Be Found By a Jury, Just Like Facts That Increase the Maximum Criminal Sentence

Whether a defendant faces “liability” for a particular monetary penalty under the federal securities laws depends not only on whether the defendant violated the securities laws, but also on whether additional facts are present so as to trigger application of a particular penalty tier. In order for a defendant to be liable under the securities laws for anything other

than the \$5,000 base penalty, some fact finder must find (1) the number of violations, (2) whether and to what extent the defendant received pecuniary gain as a result of the violation, (3) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (4) the causal connection between the violation and any gains or losses, and (5) whether the violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses.

We believe that, under *Tull*, a civil defendant has a right to a jury determination of these additional facts. Each fact is needed to render the defendant liable for a higher maximum penalty than that to which the defendant would be exposed based on a simple finding that he or she committed a single securities violation. Stated another way, each of these facts is needed to give rise to “liability” for a particular penalty. Accordingly, *Tull* requires that the jury find those facts. Only after the jury has found the facts necessary to expose a defendant to the maximum penalty in a given tier (or for a certain number of violations) can a judge use her discretion to determine the appropriate sanction up to that maximum. Simply put, the jury must find the facts that determine the applicable penalty range before the judge is entitled to select a penalty within that range.

This reading of the Seventh Amendment jury trial right is bolstered by the U.S. Supreme Court’s recent Sixth Amendment jurisprudence. The Sixth Amendment, “in conjunction with the Due Process Clause, requires that each element of a crime be proved to the jury beyond a reasonable doubt.”[16] In *Apprendi v. New Jersey*, the Supreme Court held that the Sixth Amendment dictates that “any fact that increases the penalty for a crime beyond the prescribed statutory maximum must be submitted to a jury.”[17] And “the relevant inquiry is one not of form, but of effect — does the required finding expose the defendant to a greater punishment than that authorized by the jury’s guilty verdict?”[18] If so, then the finding must be made by the jury. Only then may the judge find the facts “that support[] a specific sentence within the range authorized by the jury’s finding that the defendant is guilty of a particular offense.”[19]

The *Apprendi* principle is not limited to incarceration; it applies with equal force to the imposition of criminal fines. In *Southern Union Co. v. United States*, the Supreme Court held that *Apprendi* acts to “broadly prohibit judicial factfinding that increases maximum criminal ‘sentence[s],’ ‘penalties,’ or ‘punishment[s]’ — terms that each undeniably embrace fines.”[20]

The *Apprendi* court relied in part on the “historical foundation” of due process and the common law role of the jury trial “[t]o guard against a spirit of oppression and tyranny on the part of rulers” and to act “as the great bulwark of [our] civil and political liberties.”[21] Significantly, the Founders’ vision of the jury’s role as the preferred fact finder was not dependent on whether that jury was civil or criminal.[22] In both civil and criminal contexts, “juries have been understood to have similar societal functions, including checking the abuse of governmental power, determining disputed facts, injecting community values into legal decisions, and aiding public acceptance of legal determinations.”[23]

Conclusion

A fair reading of the Supreme Court’s recent Sixth Amendment jurisprudence suggests that, under *Tull*, the Seventh

Amendment entitles a defendant to a jury finding of those facts that lead to a higher maximum penalty. The right to a jury trial under both the Seventh and Sixth Amendments is meant to check the power of the government. Just as a criminal defendant under the Sixth Amendment is entitled to a jury finding on all facts that increase the statutory maximum sentence, the Seventh Amendment similarly entitles a civil defendant to a jury finding of “liability,” which includes any facts that increase the statutory maximum monetary penalty.

The court itself has explained that *Tull* rested on the notion that a government civil penalty action is analogous to criminal sentencing. Congress has threatened certain penalties for simply violating the federal securities laws and other penalties for violations that involve fraud or result in pecuniary gain to the defendant or loss to victims. Whether these higher penalties apply depends on factual findings, the making of which is quintessentially a jury function. And whether a defendant is liable for these higher penalties seems to fall squarely within *Tull*’s holding that the question of “liability” for a penalty is one for the jury.

For all these reasons, we think that the proper reading of *Tull* is that the facts necessary to expose a defendant to a higher penalty tier must be found by a jury. In subsequent articles we will explain how this principle would apply to (1) the number of so-called “violations”; (2) whether the defendant’s violation resulted in or created a risk of substantial loss, as well as the amount of any such loss; and (3) whether the defendant acted with fraudulent intent.

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[1] *SEC v. Solow*, 554 F. Supp. 2d 1356, 1367 (S.D. Fla. 2008) (noting the “uncertainty” regarding the factual findings that a jury must make before a judge may impose a particular penalty).

[2] A more comprehensive analysis of these issues can be found at Matthew T. Martens and Troy A. Paredes, *The Scope of the Jury Trial Right in SEC Enforcement Actions*, 71 N.Y.U. Ann. Surv. Am. L. 147 (2016).

[3] See Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. 101-429, 104 Stat. 931 (Oct. 15, 1990).

[4] 15 U.S.C. §§ 77t(d), 78u(d), 80a-41(e), 80b-9(e).

[5] Id. §§ 77t(d)(2)(A), 78u(d)(3)(B)(i), 80a-41(e)(2)(A), 80b-9(e)(2)(A).

[6] Id. §§ 77t(d)(2), 78u(d)(3)(B), 80a-41(e)(2), 80b-9(e)(2). 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 a natural person 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.

[7] 481 U.S. 412 (1987).

[8] Id. at 414.

[9] Id. at 422.

[10] Id. at 425.

[11] Id.

[12] *Feltner v. Columbia Pictures Television Inc.*, 523 U.S. 340, 354 (1998).

[13] Id. at 354 n.8.

[14] Id. at 355.

[15] Liability, Merriam-Webster, <http://www.merriam-webster.com/dictionary/liability> (last visited June. 22, 2016).

[16] *Alleyne v. United States*, 133 S. Ct. 2151, 2156 (2013).

[17] 530 U.S. 466, 490 (2000).

[18] Id. at 494.

[19] Id. at 494 n.19.

[20] 132 S. Ct. 2344, 2351 (2012) (alterations in original) (quoting *Blakely v. Washington*, 542 U.S. 296, 304 (2004); *Apprendi*, 530 U.S. at 490; *Ring v. Arizona*, 536 U.S. 584, 589 (2002)).

[21] 530 U.S. at 477 (second alteration in original) (quoting 2 J. Story, *Commentaries on the Constitution of the United States* 540-41 (4th ed. 1873)).

[22] See Colleen P. Murphy, Integrating the Constitutional Authority of Civil and Criminal Juries, 61 *Geo. Wash. L. Rev.* 723, 745 (1993).

[23] Paul F. Kirgis, The Right to a Jury Decision on Sentencing Facts After Booker: What the Seventh Amendment Can Teach the Sixth, 39 *Ga. L. Rev.* 895, 903 (2005).