Nos. 21-55178(L), 21-55180

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

U.S. SECURITIES AND EXCHANGE COMMISSION,

***Plaintiff-Appellee*,**

v.

JOCELYN M. MURPHY, MICHAEL S. MURPHY, and RICHARD C. GOUNAUD,

***Defendants-Appellants*.**

On Appeal from the United States District Court
for the Southern District of California
No. 3:18-cv-01895-AJB-LL
Hon. Anthony J. Battaglia

AMICUS CURIAE BRIEF OF THE NEW CIVIL LIBERTIES ALLIANCE IN SUPPORT OF PETITION FOR REHEARING *EN BANC*

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CORPORATE DISCLOSURE STATEMENT

The New Civil Liberties Alliance has no parent corporation. No publicly held corporation owns any of the stock of the New Civil Liberties Alliance.

Date: November 28, 2022

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INTEREST OF AMICUS CURIAE

The New Civil Liberties Alliance ("NCLA") is a nonpartisan, nonprofit civil rights organization and public-interest law firm. Professor Philip Hamburger founded NCLA to challenge multiple constitutional defects in the modern administrative state through original litigation, *amicus curiae* briefs, and other advocacy.[1]

NCLA is particularly concerned when administrative agencies use their putatively "civil" law enforcement powers to seek and impose draconian financial penalties against American citizens without the due process and procedural protections historically associated with criminal judicial proceedings. NCLA is further troubled when these agency penalties are calculated using arbitrary and inconsistent multipliers that: (i) are untethered to the text of the authorizing penalty statutes; (ii) result in penalties vastly exceeding the statutory limits set by Congress; and (iii) produce wildly disparate penalties against similarly-situated defendants—all of which occurred in the instant case.

[1] All parties have consented to the filing of this brief. No counsel for any party authored any part of this brief. No one other than the *amicus curiae*, its members, or its counsel financed the preparation or submission of this brief.

INTRODUCTION

Amicus curiae NCLA respectfully supports rehearing *en banc* so the full Court can bring desperately needed consistency, clarity, and discipline to the calculation of putatively "civil" penalties in enforcement cases prosecuted by Plaintiff-Appellee Securities and Exchange Commission ("SEC"). Although Congress has not changed SEC's baseline statutory penalty limits since adopting them in 1990 (other than allowing periodic adjustments for inflation), the magnitude of SEC penalties has expanded in recent decades to a point where any daylight between those penalties and criminal fines has effectively disappeared.

SEC recently announced its enforcement penalties for the fiscal year ended September 30, 2022. *See* SEC Press Rel. No. 2022-206 (Nov. 15, 2022). Among other milestones, SEC boasted a staggering $4.2 *billion* in civil penalties imposed during just the past fiscal year—the agency's "highest on record." *Id*. The $4.2 billion record was more than triple SEC's average annual penalty totals over its preceding five fiscal years. And when divided by the approximately 450 "standalone" enforcement cases SEC files in a typical fiscal year, last year's $4.2 billion total works out to an average penalty of more than $9 million per case. SEC fines of that magnitude—and higher—are now commonplace, although it seems only yesterday the agency was touting its $10 million penalty against Xerox

Corporation as "the largest fine ever obtained by the SEC against a public company in a financial fraud case." SEC Press Rel. No. 2002-52 (Apr. 11, 2002).

Today's eye-popping SEC penalties are impossible to square with the statutory penalty caps legislated by Congress. Even with a succession of inflation adjustments over the past 30 years, the applicable statutes still cap SEC penalties at just over $10,000 per violation for natural persons in the absence of fraud or investor losses, and at slightly over $100,000 for non-natural persons for similar violations. Even in fraud cases with substantial investor losses, the statutes cap SEC penalties at slightly over $200,000 per violation for natural persons and slightly over $1 million per violation for non-natural persons.

All of which suggests an obvious question: Given these statutory penalty limits, how does SEC collect billions in penalties each year from a docket of only about 450 cases?

One way is through mega-dollar settlements with deep-pocketed companies and individuals desperate to avoid years of public litigation against their primary federal regulator. According to academic research and anecdotal evidence, SEC manages to extract settlements in the overwhelming majority of its enforcement cases without having to prove its charges or justify the agreed-upon fine. Indeed, most of SEC's largest fines come from settlements rather than contested litigation. *See generally* David Rosenfeld, *Civil Penalties Against Public Companies in SEC*

Enforcement Actions: An Empirical Analysis, 22 U. PA. J. BUS. L. 135, 155-63, 179-88 (2019) (hereinafter "Rosenfeld") (noting that the lack of standards, transparency, and consistency in high-dollar SEC settlements, which "often bear little relation to the statutory framework," can lead to "cynicism about the process" and "a generalized sense that the penalty number is wholly arbitrary and disconnected to the actual misconduct").

But even in fully litigated cases, SEC has an effective trick up its sleeve: Arbitrarily slicing up violations into multiple (often numerous) component pieces, and then demanding the statutory maximum for each piece. Dividing violations can geometrically inflate the penalty in any given case. And doing so allows SEC and courts to feign magnanimity, as happened in the present case, by telling penalized parties they should consider themselves lucky because a little more ingenuity could have multiplied their violations by slicing them even thinner.

One respected commentator's hypothetical example is instructive. Positing a public company with 50,000 investors that recklessly misstated its financial results in annual and quarterly SEC filings over a two-year period, he illustrates how the SEC could theoretically manipulate the maximum penalty amount to be anywhere from $775,000 to $1.24 *trillion* depending entirely on how SEC slices and counts the violation. *See* Jonathan Eisenberg, *How SEC Judges Calculate Civil Monetary Penalties*, LAW360 (Jan. 22, 2016); *accord* Samuel N. Liebmann, Note, *Dazed and*

Confused: Revamping the SEC's Unpredictable Calculation of Civil Penalties in the Technological Era, 69 DUKE L.J. 429, 431 (2019) (hereinafter "Liebmann") (noting that penalties are "virtually limitless" for high-frequency algorithmic trading firms if each individual trade is separately penalized).

The instant case presents a paradigmatic example of the kind of arbitrary violation-slicing SEC has gotten away with for far too long. In this case, the violations not only were sliced more thinly than the applicable statutes can bear, but the slicing was completely haphazard and arbitrary, resulting in egregiously inflated and disproportionate penalties that should be reversed and remanded with intelligible guidelines articulated by the *en banc* Court.

ARGUMENT

I. SEC's Statutory Power to Penalize

For 50 years after its creation in 1934, SEC lacked statutory power to seek or impose monetary penalties. The agency could seek court injunctions and ancillary equitable remedies against wrongdoers, and it could impose bars and suspensions administratively, but Congress initially gave the agency no power to punish. *See generally* Eisenberg, *supra*; *see also* Rosenfeld at 138-39; Liebmann at 435-36.

That changed in 1984, when Congress empowered SEC to seek monetary penalties in court for insider trading violations in an amount up to three times the trader's illicit profits or losses avoided. *See* Rosenfeld at 139; Liebmann at 436. Six

years later, Congress expanded SEC's punitive powers by allowing the agency to seek monetary penalties in court against *any* securities-law violator and to impose penalties administratively against firms and individuals operating within the SEC-regulated securities industry. *See* Rosenfeld at 140-41; Liebmann at 436-37; Ralph Ferrara, *et al*., *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 BUS. LAW. 33 (1991). Most recently, in 2010, Congress further expanded SEC's power by allowing the agency to impose penalties *administratively* against any securities law violator—not just those operating in the securities industry. *See* Rosenfeld at 141; Liebmann at 435-36.

Whether SEC seeks penalties in court or imposes them administratively, the penalties (other than for insider trading) are generally governed by a three-tier statutory framework. Different statutory provisions apply depending on which securities-law provision is violated and whether SEC seeks its penalties in court or imposes them administratively, but with several exceptions not relevant here, the three-tier structure is similar regardless of venue.[2]

[2] One difference depends on whether SEC sues a violator in federal court or charges the violator in its own administrative adjudication system. In court cases, unlike administrative cases, SEC and the district court can alternatively penalize a securities-law violator—regardless of whether there is fraud or investor losses—in an amount equal to the violator's "gross amount of pecuniary gain." *Compare, e.g.*, 15 U.S.C. § 78u(d)(3)(B) (court cases), *with id*. § 78u-2(b) (administrative cases). That distinction is irrelevant here because the defendants-appellants' gross

As relevant here,[3] the penalty structure works like this: The baseline *maximum* penalty (adjusted for inflation) is currently $10,360 per violation for natural persons and $103,591 per violation for any other persons; if a violation involved "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," the baseline maximum per violation increases to $103,591 and $517,955, respectively; and if the violation *also* "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons," the baseline maximum per violation increases further to $207,183 and $1,035,909, respectively.

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pecuniary gain in this case was relatively modest, so neither SEC, the district court, nor the panel relied on that alternative penalty option.

A more semantic difference is that when SEC sues in court the statutory maximum is assessed "[f]or each violation," *id*. § 78u(d)(3)(B), whereas the maximum in administrative adjudications is assessed "for each act or omission," *id*. § 78u-2(b). This textual difference does not appear to impact the penalty analyses conducted by SEC or the courts, and if anything suggests that leeway to slice violations is more restricted in court cases.

Finally, for reasons unclear to *amicus*, the current maximums under the Securities Act of 1933 appear to have been given a slightly smaller inflation adjustment than the maximums under other statutes administered by SEC. This disparity is irrelevant here because the penalties were not imposed under the Securities Act.

[3] Relevant here are the penalties for violations of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d)(3)(B), as periodically adjusted for inflation at 17 C.F.R. § 201.1001 *et seq*. and most recently by SEC's Adjustments to Civil Monetary Penalty Amounts, 87 Fed. Reg. 1808 (Jan. 12, 2022).

Despite legislating in this area on several occasions, Congress has not provided any intelligible principles to guide the SEC or the courts in determining how to calculate the number of violations in any given case—a critical input in determining (and limiting) the magnitude of any potential penalty. And therein lies the rub, as the instant case illustrates exquisitely.

II. The Prevailing Chaos and Confusion

As a matter of simple math, how SEC or the court counts the number of violations can impact the magnitude of any penalty dramatically. *See, e.g.*, Eisenberg, *supra*. If—as SEC, the district court, and the panel all suggested here—SEC and the courts have broad discretion to slice up a violation into many component pieces using any number of possible slicing techniques, and then to use that number as a penalty multiplier, there's effectively no statutory limit to the penalty in many cases. Hence, the prosecutor doing the slicing, instead of Congress, sets the penalty.

Moreover, as occurred in this case, SEC and the courts can feign magnanimity—while blithely dismissing objections that the penalty is excessive under the Eighth Amendment—by insisting that defendants should consider themselves lucky because an even higher penalty could have been set. Panel Op. at 27. In truth though, this means defendants cannot know in advance what penalty they face for their conduct because how violations get sliced varies so considerably.

See generally Rosenfeld at 179-88 (noting SEC's lack of consistency and transparency in calculating penalties, especially in settled cases, where the agency "never explains how the penalty was calculated" and the amount "often bears little relation to the statutory framework").

The panel opinion identified several violation-slicing techniques the SEC and the courts have used in SEC cases. Panel Op. at 27. It cited with approval cases in which courts "looked to" either the number of investors defrauded, the number of fraudulent transactions, the number of different statutes violated, or the number of distinct schemes involved. *Id*. (citations omitted). The panel ultimately affirmed the district court's use of two *additional* methods for counting the violations of the three defendants-appellants here: the number of misleading communications sent by one defendant-appellant (Jocelyn Murphy) and the number of months during which the other two lacked proper registration with SEC as broker-dealers (Michael Murphy and Richard Gounaud). *Id*. at 26-28.

The resulting penalties for all three defendants-appellants were draconian. Jocelyn Murphy, whose violations were found to have involved fraud, was tagged with a "tier two" penalty multiplied by a factor of 21 for each individual communication where she allegedly provided misleading information, for a total penalty of $1,761,920. Michael Murphy and Richard Gounaud—neither of whom was charged with fraud—were each tagged with "tier one" penalties multiplied by

the number of months each traded securities while not registered with the SEC as a broker-dealer, resulting in penalties of $523,863 for Murphy (65 months) and $385,641 for Gounaud (46 months).

The relevant statutory text does not support the district court's penalty multipliers. That statute, 15 U.S.C. § 78u(d)(3), authorizes relatively modest penalties assessed "[f]or each violation"—*not* for each communication sent in connection with a violation and *not* for each random unit of time a defendant was in violation. Indeed, the unit-of-time multiplier is especially arbitrary and limitless. By its logic, why stop at multiplying per month? Why not treat each week as a separate violation, or each day, or even each hour?

The D.C. Circuit specifically rejected this unit-of-time approach in *Rapoport v. SEC*, 682 F.3d 98 (D.C. Cir. 2012), a case decided on deferential review from an SEC administrative adjudication. The court described an SEC administrative law judge's multiplication of the maximum statutory penalty by a factor of five—one for each year (not month) during which a violation persisted—as "a faulty formula" that resulted in "calculations [that] do not follow the formula set by the statute." *Id*. at 107-08. The court further described the ALJ's penalty analysis as "not just superficial; it was nonexistent." *Id*. at 108.

Beyond its inconsistent violation-counting across the three defendants-appellants, the district court vastly departed from how it had counted comparable

violations of ten settling co-defendants *in the same case*. Although the record is not entirely clear how those co-defendants' violations were counted for penalty purposes, with one exception the penalty amounts—all round-dollar figures well within the applicable statutory minimum—strongly suggest that the district court counted only a single violation and applied no multipliers.[4]

For example, despite being charged with scienter-based fraud *in addition to* failing to register as broker-dealers (charges roughly comparable to those against Jocelyn Murphy), six of the settling co-defendants were penalized only $45,000 and two others only $70,000—comfortably below the statutory maximum and less than five percent of the penalty later ordered against Jocelyn Murphy. The lone outlier, a co-defendant SEC's complaint portrayed as the ringleader of everything, was ordered to pay $150,000.

The last co-defendant, who was charged only with trading securities while unregistered with the SEC as a broker-dealer (charges comparable to those against Michael Murphy and Richard Gounaud), was ordered to pay what plainly looks like a single "tier one" penalty of only $7,500—again below the statutory maximum and only a small fraction of the penalties later imposed on Murphy and Gounaud for comparable offenses.

[4] The same appears to be the case with others who settled separate but comparable SEC cases in recent years, as reflected in a compendium submitted for the district court's consideration. *See* 2-ER-90-93.

There's no obvious rationale for the vast disparity between the draconian penalties levied against the three defendants-appellants and the relatively modest ones levied against their similarly situated co-defendants, other than the latter settled while the former had the temerity to defend themselves and put SEC's case to the test of litigation. Indeed, the panel decision specifically emphasized this distinction, ominously suggesting that it rendered consistency and proportion unnecessary. Panel Op. at 28-29.[5]

III. *En Banc* Rehearing Is Warranted

The panel decision upheld textbook examples of the kinds of arbitrary, inconsistent, excessive, and disproportionate penalty calculations that often result when courts defer to imaginative SEC violation-slicing. The district court's violation-slicing techniques were untethered to the text of the relevant statute, and its unit-of-time multiplier was rejected by the D.C. Circuit's decision in *Rapoport*.

Beyond correcting these errors in the district court's penalty analysis, however, this Court's *en banc* consideration and guidance are desperately needed to bring clarity, consistency, and discipline to the imposition of monetary penalties in SEC enforcement cases more broadly—an astonishing $4.2 billion enterprise last year alone.

[5] Adding to the arbitrariness of the district court's penalty calculation was an unexplained 20% discount the court applied to each of the penalties. *See* Panel Op. at 28-29.

CONCLUSION

The Court should rehear this case *en banc*.

Date: November 28, 2022

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), I certify that:

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 2,691 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionately spaced typeface using Microsoft Word 2016 Times New Roman 14-point font.

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CERTIFICATE OF SERVICE

I hereby certify that on November 28, 2022, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

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