No. 22-1241

In The
Supreme Court of the United States

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

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF SECURITIES SCHOLARS AND FORMER SEC OFFICIALS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

LYLE ROBERTS
Counsel of Record
MARK LANPHER
SHEARMAN & STERLING LLP
401 9th Street, NW
Washington, DC 20004
(202) 508-8108
lyle.roberts@shearman.com

Counsel for Amici Curiae

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Page(s)**

Statutes

Regulations

Other Authorities

INTEREST OF AMICI CURIAE[1]

Amici curiae are law professors and former officials of the Securities and Exchange Commission ("SEC"). They have spent years studying and advising on the federal securities laws, the SEC's enforcement practices, and the economics of settlement and litigation. They have an interest in the appropriate construction and operation of the laws in those areas.[2]

- Ronald J. Colombo – Professor of Law and Dean for Distance Education at the Maurice A. Deane School of Law at Hofstra University.
- Richard A. Epstein – The Laurence A. Tisch Professor of Law at the New York University School of Law, the Peter and Kirsten Bedford Senior Fellow at The Hoover Institution, and the James Parker Hall Distinguished Service Professor of Law, Emeritus, and Senior Lecturer at the University of Chicago Law School.
- Joseph A. Grundfest – Commissioner of the SEC (1985-1990); currently The William A. Franke Professor of Law and Business (emeritus), Stanford Law School, and Senior Faculty of the Rock

[1] No counsel for a party wrote this brief in whole or in part, and no one other than amici curiae or their counsel contributed money to fund the preparation or submission of this brief. Counsel of record for the parties received notice of amici's intent to file this brief at least ten days before its due date.

[2] The views in this brief are those of the amici curiae only and not necessarily of any of the institutions with which they are or have been affiliated. The names of the institutions are included for identification only.

Center on Corporate Governance at Stanford University.

- Simon Lorne – Vice Chairman and Chief Legal Officer, Millennium Management LLC; General Counsel of the SEC (1993-1996); member and former Chairman of the Board of Directors of the Alternative Investment Management Association (AIMA); former partner, Munger, Tolles & Olson LLP; former faculty member, the University of Pennsylvania Law School, the University of Southern California Law School, the NYU Law School, and the Stern School of Business at NYU; former co-director, Stanford Law School Directors' College; Adjunct Professor of Law at the University of Texas School of Law.
- Amanda M. Rose – Cornelius Vanderbilt Chair in Law at Vanderbilt University Law School, and Professor of Management at Vanderbilt University Owen Graduate School of Management.
- Matthew Turk – Associate Professor of Business Law & Ethics at Indiana University Kelley School of Business.
- Andrew N. Vollmer – Senior Affiliated Scholar, Mercatus Center at George Mason University; former Professor of Law, General Faculty, University of Virginia School of Law; former Deputy General Counsel of the SEC; former partner in the securities enforcement group of Wilmer Cutler Pickering Hale and Dorr LLP.

The amici curiae are unanimous in their view that the uncertainty and lack of legal guidance about the definition of a "violation" for purposes of calculating a penalty amount in litigation with the SEC warrants the Court's review. They express no view on the appropriate resolution of that question and might disagree about the proper interpretation of the relevant statutes.

SUMMARY OF ARGUMENT

The purpose of this brief is to describe certain practical aspects of the SEC enforcement program affected by the lack of clear and consistent legal standards for interpreting the statutes that set civil monetary penalty amounts in SEC enforcement cases. These practical considerations support the Petition's request for this Court's review.

The SEC seeks money penalties in nearly every enforcement case it brings. In fiscal 2022, the SEC and courts ordered that defendants pay $4.2 *billion* in civil monetary penalties. Nonetheless, no uniform and predictable interpretation of the SEC penalty statutes exists.

The absence of legal standards to set penalty amounts particularly affects settlement negotiations, which occur in a high percentage of SEC cases. As a result, these cases largely are settled on a "blind basis" where the defendants do not know what penalty actually could be imposed by a court or the SEC if they unsuccessfully litigated the SEC's claims.

Indeed, because all defendants, but especially public companies and regulated persons, are under enormous pressure to settle SEC enforcement cases, the lack of legal rules interpreting the statutory penalty amounts puts defendants largely at the mercy of the SEC staff when agreeing to a penalty. A neutral adjudicator rarely referees an agreed penalty amount, meaning that the SEC has virtually unfettered discretion to decide the appropriate penalty amount, often without regard to the relevant statutory language. The Court should review this case to determine whether Congress meant to confer such broad discretion on the SEC in the computation of penalty amounts.

ARGUMENT

The first question presented in the Petition raises important legal issues affecting SEC enforcement and therefore capital formation in U.S. securities markets. We encourage the Court to grant review of this question, and we support the Petition by discussing several practical considerations demonstrating that the absence of meaningful and predictable interpretations of the SEC penalty statutes has harmful consequences.

First, we supplement the Petition's discussion of the inconsistent, atextual, and case-specific judicial interpretations and applications of the penalty statutes. *Second*, we explain that a high percentage of SEC enforcement cases settle and that the lack of uniform interpretations of the SEC penalty statutes transfers disproportionate bargaining power to the SEC in a way that leads to extremely large penalty assessments and results in unfairness to defendants.[3]

The SEC's statutory penalty regime.

Congress authorized district courts and the SEC to impose civil monetary penalties in enforcement

[3] A defendant in an administrative proceeding is called a respondent. For convenience, this brief will refer only to defendants.

cases. One set of provisions applies in district courts, and another set, with slightly different wording, applies in SEC administrative proceedings ("APs").[4] Both establish three tiers of penalty amounts. The amounts increase for violations involving fraud or a deliberate disregard of a regulatory requirement, and then again for violations involving substantial losses or the risk of substantial losses to third parties. Each penalty tier has a specific dollar limit for natural persons and a higher dollar limit for any other person. A district court may impose a penalty up to the higher of the specific dollar limit or the gross amount of pecuniary gain to the defendant from the violation.

In district courts, the penalty amounts apply to "each violation" of a securities law or of a cease-and-desist order entered by the SEC. In an AP, the penalty amounts apply to certain specified acts or omissions, but the main basis for a penalty is a violation of the securities laws.

The SEC is required to increase the statutory maximum amounts each year based on inflation. The range of maximum penalty amounts in district courts is currently $11,162 (tier 1 for individuals) to $1,116,140 (tier 3 for legal entities). SEC Rel. Nos. 33-11143, 34-96605 (Jan. 6, 2023), https://www.sec.gov/rules/other/2023/33-11143.pdf; 17 C.F.R. § 201.1001.

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[4] 15 U.S.C. §§ 78u(3), 78u-2. This brief does not address the penalty statute for insider trading. *Id.* § 78u-1.

Meaningful and consistent legal interpretations of the penalty statutes do not exist.

The courts and the SEC have not developed predictable, consistent, and textually based standards for defining a violation or applying the penalty statutes. The courts are divided on how to calculate penalty amounts, as the Petition describes (13-21).

The SEC and its administrative law judges ("ALJs") have fared no better, similarly developing and applying inconsistent and varying standards for calculating penalty amounts. *See In the Matter of Laurie Bebo*, No. 3-16293, 2020 WL 4784633, at *107 (S.E.C. Aug. 13, 2020) (observing that Commission opinions have taken inconsistent approaches with respect to penalties, and that a review of federal court cases revealed "at least three other robust approaches – one for which penalties are based on the number of transactions or misstatements, another for which penalties are based on the number of victims, and a third for which penalties are based on the number of statutory provisions violated.").

Indeed, a study of 28 SEC AP cases decided between 2013-2016 found that the most consistently applied standard was a "course-of-conduct" standard, which combines related acts into a single course of conduct and treats the single course of conduct as a single act or omission for civil money penalty purposes, but the "course-of-conduct" standard was applied in only just over a third of the cases reviewed. The other two-thirds of cases employed a variety of other standards with difficult to reconcile methodologies and often appeared to back into the amount of the penalty imposed. *See* Jon Eisenberg, *Calculating SEC Civil Money Penalties: Do Hundreds of Related*

Acts Constitute a Single Course of Conduct or Hundreds of Separate Violations?, K&L Gates Legal Insight (Jan. 19, 2016); *see also* Samuel N. Liebmann, *Dazed and Confused: Revamping the SEC's Unpredictable Calculation of Civil Penalties in the Technological Era*, 69 Duke L.J. 429, 440-41 (2019) (discussing the lack of consistency in the SEC's penalty approach, and observing: "The number of 'acts or omissions' present in any illegal scheme could be measured by the number of illegal transactions, the number of investors injured, the number of fraudulent statements made to investors, the number of distinct acts of negligence, or the duration of the fraud.").

As a recent commentator has noted, how SEC civil monetary penalties "are calculated and on what bases, and how the penalties relate to the underlying misconduct remains largely opaque." David Rosenfeld, *Civil Penalties Against Public Companies in SEC Enforcement Actions: An Empirical Analysis*, 22 U. Pa. J. Bus. L. 135, 179 (2019) (Rosenfeld). "Despite the statutory maximums, in some cases there is practically unlimited potential liability, which in turn gives rise to a penalty framework that is almost entirely discretionary." *Id.* at 180.

The absence of legal guidance on SEC penalty statutes has national importance.

The lack of consistent and predictable legal standards for assessing civil penalties in SEC cases matters to the securities markets and the national economy. The securities laws regulate the formation of capital in the United States securities markets, and the SEC's enforcement program is a critical component of the administration of the securities laws. The lack of rules interpreting the penalty statutes affects nearly every SEC enforcement case and is particularly troubling in the large number of settled cases.

In the past four fiscal years, the SEC brought 1827 enforcement cases: 462 in fiscal 2022, 434 in fiscal 2021, 405 in fiscal 2020, and 526 in fiscal 2019. The SEC or courts ordered a total of $4.194 billion in civil monetary penalties in fiscal 2022, $1.456 billion in fiscal 2021, and approximately $1.1 billion in each of fiscal 2020 and 2019.[5]

A very high percentage of SEC enforcement cases settle before final resolution, perhaps as much as 98 percent.[6] Only a few cases reach a final resolution on the merits by an ALJ, judge, or jury.

Moreover, a significant portion of SEC cases settle simultaneously with initiation. A study of SEC enforcement cases for fiscal years 2007 through 2017 showed that an average of 41 percent of cases each year settled at the time of commencement, with an

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[5] SEC Division of Enforcement, Addendum to Division of Enforcement Press Release, Fiscal Year 2022 (Nov. 15, 2022) (reporting number of "standalone" enforcement actions separate from related, or "follow-on," and other types of claims), https://www.sec.gov/files/fy22-enforcement-statistics.pdf.

[6] *SEC v. Moraes*, 2022 WL 15774011, at *2 n.5 (S.D.N.Y.) ("While going to trial is always an option, it remains infrequent at the SEC. The SEC currently settles approximately 98% of its Enforcement cases.") (quoting Luis A. Aguilar, Commissioner, U.S. Sec. & Exch. Comm'n, *Remarks Before the 20th Annual Securities and Regulatory Enforcement Seminar* (Oct. 25, 2013)); Rosenfeld 163 & n.128.

annual high of 55 percent and a low of 32 percent.[7] A separate study of SEC cases brought against public companies and their subsidiaries showed that 93 percent of the cases in fiscal 2022 were filed and settled at the same time.[8] As discussed below, the high rate of settlements at the time of filing hinders the development of usable legal standards for setting penalty amounts.

SEC settlements typically are accompanied by the imposition of a civil money penalty on the defendant. The total amount of civil penalties each year in SEC cases evidences their pervasive use. In addition, in one study of SEC enforcement cases against public companies, 309 cases were filed in fiscal years 2015 through 2018 (299 of the cases, or 97 percent, were settled at the time of filing), and 268 of the resolved cases (or 87 percent) included penalties. Rosenfeld 157.

The large number of settlements with accompanying civil penalties contributes to the scarcity of sound legal interpretations of the penalty statutes. Settlements reduce judicial or ALJ scrutiny of penalty calculations and the development of reasoned and consistent analysis of the meaning of the penalty statutes. Judges review settlements in district courts but generally defer to the outcomes negotiated between the SEC and the defendant. *See SEC v.*

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[7] Brief For Urska Velikonja and Joseph A. Grundfest as Amici Curiae in Support of Neither Party, at 11, *Lucia v. SEC*, 138 S. Ct. 2044 (2018) (No. 17-130).

[8] Cornerstone Research, *SEC Enforcement Activity: Public Companies and Subsidiaries, Fiscal Year 2022 Update*, at 5 (2022).

Citigroup Global Markets, Inc., 752 F.3d 285, 296 (2d Cir. 2014) ("determining whether the proposed S.E.C. consent decree best serves the public interest … rests squarely with the S.E.C., and its decision merits significant deference").

For settled APs, no review of penalty amounts occurs outside of the SEC staff and the SEC's commissioners, *see* 17 C.F.R. § 201.240, and, for the past several years, the SEC has assigned nearly all cases settling at the time of commencement to its internal administrative process and has not filed them in federal district court.[9] Several reasons explain this choice, but a major one is that the SEC evades any independent court or even ALJ scrutiny of the penalty amounts and other settlement terms.[10] An SEC Director of Enforcement acknowledged this benefit of settling in administrative proceedings, employing the euphemism of avoiding "busy district court dockets."[11]

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[9] Sixty of the 63 cases in 2022 against public companies that were filed and settled at the same time were filed as APs. Of 68 total cases against public companies, approximately 8 were filed in district court, including all 5 of the contested cases. *See* Cornerstone Research 5, cited in note 8 above. *See also* Rosenfeld 189 (overwhelming majority of settled actions against public companies "have been in administrative proceedings rather than federal court actions").

[10] *See* Rosenfeld 190, 194 ("a settlement in an administrative proceeding need only be approved by the Commission, whereas a settlement in a federal court action is subject to approval by the court.").

[11] *See* Andrew Ceresney, Director, Sec. & Exch. Comm'n Div. of Enf't, *Remarks to the American Bar Association's Business Law Section Fall Meeting (*Nov. 21, 2014) (settling in an

The absence of standards on penalty calculations results in excessive penalty amounts.

As a matter of practice, penalty amounts in settlements often are inexplicably large and are difficult to reconcile with the language of the penalty statutes or with the penalties in similar cases. Because the SEC does not explain its methodology and defendants do not reveal negotiations or the reasons for agreeing to the amount, the size of settled penalty amounts raises questions about the interpretation of the penalty statutes that led to the result.

Consider a few high-profile examples from the past 20 years.

First, in 2022, the SEC brought a series of cases against broker-dealers asserting that the regulated parties failed to meet their obligation to keep records of informal communications related to the business of the broker-dealers. The largest broker-dealers each agreed to pay a $125 million penalty. That is a large penalty for recordkeeping violations, but the legal basis for the size of the penalty is a mystery. The settled charging document for each of several defendants cited only four violations, no gain to defendants, and no loss to investors.[12] The SEC orders were silent about the number of violations that were the basis for the penalty. They alleged that the broker-dealers failed to keep tens of thousands of messages during the relevant period. The SEC might

AP "quickly ends the matter" without being subject to the "demands of busy district court dockets").

[12] *See,* *e.g.*, Barclays Capital Inc., https://www.sec.gov/litigation/admin/2022/34-95919.pdf.

have thought that it could count each unretained message as a separate violation worthy of a penalty, but a penalty of $125 million implied 2500 violations at a rate of $50,000 for a tier 1 violation for a legal entity (leaving the inflation adjustment out) or 250 violations at a rate of $500,000 for a tier 3 violation. The difficulty is that there is no way to know whether the SEC even used the penalty statutes as a benchmark.

Second, in 2019, the SEC sued an issuer of crypto tokens, asserting violations of two registration provisions. The issuer had offered one trillion tokens for sale and received approximately $55 million from buyers. Thus, the SEC could have demanded a penalty equal to the $55 million gain, or, if each offered token was considered a separate violation at the tier 1 level, it arguably could have sought a penalty equal to one trillion times $50,000 (leaving out the inflation adjustment). In 2020, the company settled for a $5 million penalty.[13] That penalty amount, which was not explained by the SEC, is further evidence of the discretionary and unpredictable application of the penalty statutes.

Third, in 2010, the SEC extracted a $535 million penalty from Goldman Sachs for a single transaction. The complaint alleged two claims for relief and referred to three buyers of the securities. Given that Goldman was required to disgorge only $15 million in ill-gotten gains in addition to the penalty amount, the pecuniary gain does not seem to provide a basis

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[13] *See* SEC Press Release, *SEC Obtains Final Judgment Against Kik Interactive For Unregistered Offering* (Oct. 21, 2020), https://www.sec.gov/news/press-release/2020-262.

for assessing a penalty so far above the generally applicable statutory maximums.[14] The SEC did not offer any explanation in announcing the penalty.

Fourth, in 2011, Citigroup settled a case with allegations similar to those in the Goldman Sachs case, and the SEC penalty again raised questions. The settled complaint asserted one claim for relief and referred to approximately 15 investors, but Citigroup ultimately agreed to a penalty of $95 million. See *SEC v. Citigroup Global Markets Inc.*, 752 F.3d 285, 289 (2d Cir. 2014), vacating and remanding 827 F. Supp. 2d 328 (S.D.N.Y. 2011). Although the $95 million penalty was $440 million less than in the Goldman Sachs case, and therefore more favorable to the defendant, it too was not explained by an interpretation of the penalty statutes or a comparison to the reasons for the penalties in the Goldman Sachs case.[15]

Finally, in 2002, the new management of WorldCom agreed to a penalty that was $500 million in cash and 10 million shares of new common stock. The amended complaint had three claims for relief, with some claims citing several different sections

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[14] *See* SEC Press Release, *Goldman Sachs to Pay Record $550 Million to Settle SEC Charges Related to Subprime Mortgage CDO* (Jul. 15, 2010), https://www.sec.gov/news/press/2010/2010-123.htm; *SEC v. Goldman Sachs & Co.*, (S.D.N.Y. filed Apr. 16, 2010), https://www.sec.gov/litigation/complaints/2010/comp-pr2010-59.pdf.

[15] SEC Press Release, *Citigroup to Pay $285 Million to Settle SEC Charges for Misleading Investors About CDO Tied to Housing Market* (Oct. 19, 2011) (linking to the complaint), https://www.sec.gov/news/press/2011/2011-214.htm.

and rules in the securities laws and several different public disclosures containing alleged material false statements. At the time of the settlement, the SEC did not explain how the alleged violations justified the $500 million penalty under the penalty statutes.[16]

The absence of standards on penalty calculations results in unfairness to defendants from arbitrary and unpredictable SEC penalty demands.

The lack of reasonable standards for SEC penalty calculations delegates enormous discretion to the SEC staff during settlement negotiations, which results in unfairness to defendants. Penalty demands are often arbitrary and unpredictable.

In settlement discussions, the SEC staff may take whatever position they want on a possible penalty amount. *See* Rosenfeld 182 ("The lack of a meaningful cap gives the agency the ability to extract settlements by threatening exorbitant penalties"; "the amount of the fine is entirely discretionary and subject to negotiation"). Defendants are not able to hold the SEC staff to compulsory benchmarks for a penalty calculation to resolve a case. When defense lawyers attempt to inject rationality or principle into negotiations about a penalty amount, the discussion rapidly descends into a staff claim that the amount turns completely on the definition of "each violation," the lack of meaningful restrictions, and the ability to

[16] *See Additional Information for Investors Regarding the Potential Distribution of the SEC's Civil Penalty Judgment Against WorldCom, Inc.* in the *SEC v. WorldCom* Case, https://www.sec.gov/spotlight/worldcom/wcominfo111103.htm.

define an extremely large number of violations.[17] In other words, settlement negotiations with the staff on penalty amounts are outside the shadow of the law. *See* Robert Cooter et al., *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. Leg. Stud. 225 (1982).

The absence of background legal standards on the meaning of the penalty statutes disadvantages defendants. Defendants are not able to compare the potential cost of a settled outcome with the risks of a litigated outcome. Defendants do not know what penalty position the SEC will take in litigation and do not know what an ALJ or court will decide if the case does not settle. Litigated penalty amounts are impossible to estimate and volatile, putting additional pressure on defendants to agree to SEC penalty demands in a settlement.

Academic research supports the proposition that the current absence of reliable interpretations of the SEC penalty statutes favors the SEC. Even if defendants can estimate the average value of the penalties that the SEC might seek to impose, the uncertainty generated by the agency's inconsistent approach to the definition of those penalty provisions gives the agency the ability to demand and obtain higher settlements. Put another way, the SEC mon-

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[17] *See* Stephen M. Cutler, Director, Sec. & Exch. Comm'n Div. of Enf't, *Remarks at the University of Michigan Law School* (Nov. 1, 2002) (stating that courts had generally imposed total penalties within the dollar amounts specified in the penalty statutes, but "the statute's specific reference to a penalty amount *per violation* clearly provides courts the latitude to view a lengthy course of illegal conduct as comprising multiple violations of the law") (italics in original).

etizes the uncertainty it creates by failing to articulate a consistent standard for the definition of a "violation." *See* Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 Stan. L. Rev. 1267, 1276 (2006) (describing litigation as a call option held by the plaintiff where increasing uncertainty or volatility in the outcome increases the claim's settlement value).

The inconsistent and varying interpretations of the SEC penalty statutes and the way the SEC wields them also raise due process concerns. A penal statute must have "sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement." *Kolender v. Lawson*, 461 U.S. 352, 357 (1983); *see also Percoco v. United States*, 598 U.S. 319, 328-31 (2023); *McDonnell v. United States,* 579 U.S. 550, 576 (2016); *Skilling v. United States*, 561 U.S. 358, 402-03 (2010).

In this case and other SEC enforcement cases, the language in the penalty statutes, as implemented by the SEC, does not give ordinary people fair notice about the consequences that will attach to conduct. *See United States v. Davis*, 139 S. Ct. 2319, 2323 (2019). It also permits arbitrary, inconsistent, and discriminatory enforcement, as illustrated above. The Court should review this case to determine an interpretive approach to the statutes to avoid these problems. The SEC's claim to such unfettered and unguided discretion should be tested.

CONCLUSION

These practical aspects of the operation of the SEC enforcement system support the need for this Court's review of the penalty assessments in this case. Do the statutes or the Constitution impose meaningful terms and restrictions on penalty calculations, or do they confer nearly unlimited discretion on the SEC and courts in the computation of penalty amounts? The petition for a writ of certiorari should be granted.

Respectfully submitted,

LYLE ROBERTS
Counsel of Record
MARK LANPHER
SHEARMAN & STERLING LLP
401 9th Street, NW
Washington, DC 20004
(202) 508-8108
lyle.roberts@shearman.com

Counsel for Amici Curiae

July 27, 2023