UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Gonnella v. Securities and Exchange Commission

No. 16-3433, United States Court of Appeals for the Second Circuit (April 2, 2020)

SUMMARY

The Second Circuit affirmed the SEC's order finding that a bond trader violated Securities Act § 17(a)(1), Exchange Act § 10(b), and Rules 10b-5(a) and (c) by engaging in a scheme to park securities with another trader to avoid internal aged-inventory charges, and that he aided and abetted his employer's books and records violations. The court held that the trader forfeited his Appointments Clause challenge to the SEC ALJ by failing to raise it during the administrative proceedings, and that the SEC's use of a cooperating witness did not violate due process or require APA notice-and-comment rulemaking. The court further held that any error by the ALJ in considering law review articles was cured by the Commission's de novo review, and that substantial evidence supported the findings of scienter and fraud. Finally, the court upheld the Commission's imposition of heightened sanctions (a lifetime bar with right to reapply in five years) on de novo review, finding it warranted in law and justified in fact.

CASE DETAILS

COURT	United States Court of Appeals for the Second Circuit
WRITING FOR THE COURT	Richard J. Sullivan; Wesley; Chin; Sullivan
JURISDICTION	Federal
DECIDED	April 2, 2020
DOCKET	16-3433
DISPOSITION	affirmed
PROCEDURAL POSTURE	Petition for review of Securities and Exchange Commission administrative order
STANDARD OF REVIEW	The findings of the Commission as to the facts, if supported by substantial evidence, are conclusive. Under the Administrative Procedure Act, the court will set aside the SEC's actions only if they are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. The court will not disturb the SEC's choice of sanction unless it is unwarranted in law or without justification in fact.
PRECEDENTIAL VALUE	Published

PARTIES	Thomas C. Gonnella v. United States Securities and Exchange Commission

TOPICS

securities fraud | administrative law | appellate procedure | waiver | due process

PRACTICE AREAS

Securities Law | Administrative Law

QUESTIONS PRESENTED

1. Whether the SEC's designation of an Administrative Law Judge who was not appointed pursuant to the Appointments Clause violated the Constitution's separation of powers.
2. Whether the SEC's use of a cooperating witness violated 5 U.S.C. § 553 and Gonnella's right to due process.
3. Whether the ALJ impermissibly engaged in independent fact-finding.
4. Whether the Commission violated due process when it increased the monetary sanctions imposed by the ALJ.
5. Whether there was sufficient evidence to support the Commission's findings of primary violations and aiding and abetting.

HOLDINGS

1. A litigant who does not object to the constitutionality of an ALJ at any point during the SEC proceedings forfeits that challenge.
2. The SEC's enforcement guidance under 17 C.F.R. § 202.12 is a policy statement not subject to APA notice and comment, and the use of cooperators does not violate due process.
3. Any error by the ALJ was cured by the Commission's de novo review, which explicitly stated it did not rely on the articles.
4. Substantial evidence supported the Commission's finding that Gonnella intentionally engaged in deceitful behavior with scienter, violating Securities Act §17(a)(1), Exchange Act §10(b), and Rules 10b-5(a) and (c).
5. Substantial evidence supported the finding that Gonnella aided and abetted Barclays' violation of Exchange Act §17(a) and Rule 17a-3(a)(2) by documenting trades without indicating the repurchase agreement, making the books inaccurate.
6. The Commission did not violate due process because its review is de novo and the ALJ's decision is not final; the Commission has authority to impose any sanction warranted by law and justified in fact.

KEY QUOTATIONS

> *“No procedural principle is more familiar to this Court than that a constitutional right may be forfeited . . . by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it.”* (at 10)

> *“one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case is entitled to relief.”* (at 11)

> *“The central question is essentially whether an agency is exercising its rule-making power to clarify an existing statute or regulation, or to create new law, rights, or duties in what amounts to a legislative act.”* (at 17)

> *“Even a universal industry practice may still be fraudulent.”* (at 23)

> *“In order for a defendant to be liable as an aider and abettor in a civil enforcement action, the SEC must prove: (1) the existence of a securities law violation by the primary party; (2) knowledge of this violation on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation.”* (at 25)

FACTUAL BACKGROUND

Thomas Gonnella was a bond trader at Barclays from 2008 to 2011. He engaged in twelve trades with Ryan King, a trader at Gleacher, to avoid Barclays' aged-inventory policy, which penalized traders for holding securities over 90 days. Gonnella sold securities to King and repurchased them after the reporting period, using coded language and failing to disclose the agreement to Barclays' compliance department. The trades were flagged as suspicious. Gonnella derived personal benefit through potential bonus increases. Barclays terminated Gonnella and disclosed the matter to the SEC.

PROCEDURAL HISTORY

The SEC initiated administrative proceedings against Gonnella. An Administrative Law Judge found violations of securities laws and imposed a cease and desist order, civil penalty of $82,500, and a twelve-month collateral and penny-stock suspension. Both Gonnella and the SEC Enforcement Division petitioned the Commission for review. The Commission affirmed the violations and imposed a lifetime bar from the securities industry with possibility of reapplication in five years. Gonnella appealed to the Second Circuit.

DISPOSITION

affirmed

CASES CITED

- Lucia v. SEC, 138 S. Ct. 2044 (2018)
- Freytag v. Commissioner, 501 U.S. 868 (1991)
- Ryder v. United States, 515 U.S. 177 (1995)
- Yakus v. United States, 321 U.S. 414 (1944)
- Cooper v. SEC, 788 F. App'x 474 (9th Cir. 2019)
- Malouf v. SEC, 933 F.3d 1248 (10th Cir. 2019)

- Kabani & Co. v. SEC, 733 F. App'x 918 (9th Cir. 2018)
- David Stanley Consultants v. Dir., Office of Workers' Comp. Programs, 2020 WL 504961 (3d Cir. Jan. 31, 2020)
- NLRB v. RELCO Locomotives, Inc., 734 F.3d 764 (8th Cir. 2013)
- Tilton v. SEC, 824 F.3d 276 (2d Cir. 2016)
- Island Creek Coal Co. v. Wilkerson, 910 F.3d 254 (6th Cir. 2018)
- Samuels, Kramer & Co. v. Commissioner, 930 F.2d 975 (2d Cir. 1991)
- Noel v. Chapman, 508 F.2d 1023 (2d Cir. 1975)
- White v. Shalala, 7 F.3d 296 (2d Cir. 1993)
- Sweet v. Sheahan, 235 F.3d 80 (2d Cir. 2000)
- United States v. Waterman, 732 F.2d 1527 (8th Cir. 1984)
- Mathis v. SEC, 671 F.3d 210 (2d Cir. 2012)
- Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38 (2d Cir. 1978)
- Newton v. Merrill Lynch, 135 F.3d 266 (3d Cir. 1998)
- Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1970)
- United States v. Naftalin, 441 U.S. 768 (1979)
- SEC v. Apuzzo, 689 F.3d 204 (2d Cir. 2012)
- Checkosky v. SEC, 23 F.3d 452 (D.C. Cir. 1994)

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