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Expert Analysis

Limitations in Sentencing Under State Criminal Securities Fraud Statutes


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New York State's Martin Act and Scheme to Defraud statute have been used by state prosecutors to combat a wide range of securities fraud, including corporate looting by the principals of Tyco, insider trading, stock manipulation, high pressure boiler room operations and perjury during testimony before self-regulator organizations.[1] Despite the seriousness of the misconduct alleged in these cases, the Martin Act and Scheme to Defraud statutes carry a surprisingly light sentencing punch. Indeed, defendants convicted of a Martin Act or Scheme to Defraud felony cannot be sentenced to a period of incarceration exceeding four years in prison. In sharp contrast, defendants convicted of violating New York State's other fraud-related offenses—such as grand larceny in the first degree or a violation of the Organized Crime Control Act (OCCA), New York's version of the federal RICO statute—may face sentences of up to twenty-five years in prison.

With Manhattan's next District Attorney, Cyrus Vance, clearly signaling that he will pursue white collar crime with the same vigor as the veteran outgoing Manhattan District Attorney, Robert M. Morgenthau, the limited sentencing ranges available under the Martin Act and Scheme to Defraud statutes may be ripe for review.

Sentencing Structures

The crux of the problem with the Martin Act and Scheme to Defraud statute is that they incorporate sentencing structures that arguably threaten to undermine their usefulness in prosecuting serious financial frauds. A violation of each of these statutes constitutes an E-felony at most, with a single maximum sentencing range of 1⅓ to 4 years' incarceration. This singular sentencing range limits the utility of both statutes in prosecuting serious financial fraud, and stands in contrast to other New York Penal Law statutes that contain a "tiered" structure setting forth a graduated range of sentences based on the value of the loss or harm involved.

The Martin Act (N.Y. Gen. Bus. Law §§352 et seq. (McKinney 1996)) regulates the purchase and sale of securities in New York, and gives New York prosecutors broad enforcement authority to bring criminal actions, including misdemeanor cases without a showing of scienter or intent to defraud. In general, the Martin Act prohibits "fraud" and "fraudulent practices" in connection with the offer, sale or purchase of securities. In contrast to other criminal offenses, the elements of which are strictly construed, the Martin Act is broadly interpreted because it is deemed to be remedial in nature.

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The Martin Act consists of three misdemeanor provisions (N.Y. Gen. Bus. Law §§352-c(1)-(3) (McKinney 1996)), enacted in 1955, and two E-felony provisions, (N.Y. Gen. Bus. Law §§352-c(5) & (6) (McKinney 1996)), which were added to the statute in 1982. One of the E-felony provisions is violated by:

> [I]ntentionally engag[ing] in any scheme constituting a systematic ongoing course of conduct with intent to defraud ten or more persons or to obtain property from ten or more persons by false or fraudulent pretenses, representations or promises, and so obtain[ing] property from one or more of such persons while engaged in inducing or promoting the issuance, distribution, exchange, sale, negotiation or purchase of any securities or commodities.

N.Y. Gen. Bus. Law §352-c(5) (McKinney 1996).

The other E-felony provision, more frequently used by prosecutors, is violated by:

> [I]ntentionally engag[ing] in fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale, or…mak[ing] any material false representation or statement with intent to deceive or defraud, while engaged in inducing or promoting the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any of securities or commodities.

N.Y. Gen. Bus. Law §352-c(6) (McKinney 1996).

The Scheme to Defraud statute makes it a crime for a person to engage in a scheme constituting a systematic ongoing course of conduct with intent to defraud either: 1) ten or more persons by false or fraudulent pretenses, representations or promises, and to so obtain property from one or more of such persons; or 2) more than one person by false or fraudulent pretenses, representations or promises, and to so obtain property with a value in excess of one thousand dollars from one or more such persons; or 3) more than one person, more than one of whom is a vulnerable elderly person…by false or fraudulent pretenses, representations or promises, and to so obtain property from one or more of such persons. N.Y. Penal Law §190.65(1) (McKinney 1998).

Despite these broad and sweeping provisions, both the Martin Act and Scheme to Defraud statute offer prosecutors a single, limited sentencing option with a maximum term of incarceration of 1⅓ to 4 years. This one-dimensional sentencing scheme contrasts with the tiered structure of other New York State criminal statutes that are aimed at economic crime.

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For example, the felony larceny statutes contain four levels of sentences that are each tied to the value of the property stolen. The sentences range from a maximum term of 1⅓ to 4 years in prison for a violation of grand larceny in the fourth degree, if the value of the stolen property exceeds $1,000, (N.Y. Penal Law §155.30(1) (McKinney 1998)), to a maximum term of 8⅓ to 25 years for grand larceny in the first degree, if the value of the stolen property exceeds $1,000,000 (N.Y. Penal Law §155.42 (McKinney 1998)).

Other statutes that are aimed at economic crime and that incorporate a tiered approach to sentencing include those for criminal possession of stolen property (N.Y. Penal Law §§165.45-165.54 (McKinney 1998)) and insurance fraud (N.Y. Penal Law §§176.15-176.30 (McKinney 1998)), in which the sentencing ranges are again tied to the value of the property stolen or obtained through a fraudulent insurance act, respectively.

This use of tiered sentencing structures in criminal cases was also used in recently enacted statutes criminalizing health care fraud (N.Y. Penal Law §§177.10-177.25 (McKinney 2006)), in which the sentences are based on the amount of payments received as a result of health care fraud, and residential mortgage fraud (N.Y. Penal Law §§187.00-187.25 (McKinney 2008)), where the applicable sentence turns on the mortgage funds fraudulently obtained.

Recent Cases

According to statistics recently provided by the Manhattan District Attorney's Office, which brings most of New York State's criminal securities fraud cases, prosecutors there indicted or filed Superior Court Informations against seven defendants for Martin Act felonies in 2005, 17 in 2006, 14 in 2007 and six in 2008 (data for 2009 year-to-date is not available). In virtually all of these cases, the defendants were also charged with other fraud-related offenses which, unlike the Martin Act, offered tiered sentencing exposure based on the seriousness of the underlying activity.

Two recent prosecutions announced by the Manhattan District Attorney highlight the contrast between the sentencing ranges available for the Martin Act and these other fraud-related crimes. In May 2009, 16 stockbrokers, traders and owners of Joseph Stevens & Company Inc. were accused by prosecutors of manipulating the market value of securities to generate more than $6.2 million in unlawful, undisclosed commissions from the firm's customers.[2] These defendants were indicted and charged with committing, amongst other offenses, grand larceny in the second degree and violations of the Martin Act for engaging in essentially the same misconduct. Should any of these defendants be convicted of committing grand larceny in the second degree, they will face a term of incarceration of up to 15 years, while the same defendants, if convicted of only violating the Martin Act, will be exposed to a markedly lower maximum term in prison of 4 years.

The same dynamic will play out in another case, announced in March 2009, in which two individuals were charged with grand larceny in the second degree and violations of the Martin Act for running The Covenant Equity Group LLC, an allegedly phony real estate investment firm which prosecutors claim cost investors more than $1 million dollars.[3]

The one-size-fits-all nature of the Martin Act and the Scheme to Defraud statute also contrasts with the structure of the Federal Sentencing Guidelines, in which the "offense level" for crimes that are of an economic nature is increased in proportion to the amount of loss involved, resulting in a wide range of available sentences. See U.S. Sentencing Guidelines Manual §§2B1.1. Moreover, the statutory maximum sentences for the federal securities fraud, mail fraud, and wire fraud statutes is twenty years. See 15 U.S.C. §§78j(b), 78ff (securities fraud); 18 U.S.C. §1341 (mail fraud); 18 U.S.C. §1343 (wire fraud).

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Alternative Approaches

The absence of a broad range of sentencing alternatives in both the Martin Act and Scheme to Defraud statute could ultimately limit the role that New York prosecutors are able to play in bringing major criminal prosecutions stemming from the current economic collapse, particularly given the higher penalties available in the federal criminal realm. Conversely, the lack of sentencing options above an E-felony could push state prosecutors to the other extreme by leading them to overcharge defendants using a heavy-handed statute like OCCA in order to take advantage of that statute's increased penalties.

One alternative at this juncture might be to leave the Martin Act and Scheme to Defraud statute as they are because their broad terms permit prosecutors to sweep more misconduct into the four corners of an indictment than would be possible under other felonies carrying the potential for harsher sentences. The breadth of the Martin Act arguably supports this view. For example, the Martin Act does not require proof that a victim of fraud relied on a defendant's misrepresentations; a conviction for grand larceny requires proof of this reliance.

Given the greater scope of misconduct covered by these statutes, a lighter sentencing scheme is clearly defensible. Moreover, the relatively lighter sentences available under the Martin Act and Scheme to Defraud statute are generally offset in the typical securities fraud statute by offenses carrying harsher sentences. Viewed from this perspective continuing to limit the sentencing options available under the Martin Act and Scheme to Defraud statute makes sense.

Another approach might be to harmonize the Martin Act and Scheme to Defraud statute with the other fraud-related crimes available to New York State prosecutors. For example, the Martin Act could be amended to increase the dollar threshold for both existing E-felonies from zero (N.Y. Gen. Bus. Law §352-c(5) (McKinney 1996)) and $250 (N.Y. Gen. Bus. Law §352-c(6) (McKinney 1996)) to $1,000, and to add three new Martin Act felonies with corresponding sentences at progressively higher levels.

The Scheme to Defraud statute could likewise be amended to incorporate the same tiered structure for progressively more serious crimes. In addition to aligning the sentencing options available in New York State criminal statutes that are aimed at financial crimes, these amendments would give state court judges the ability to sentence convicted defendants in securities fraud prosecutions to sentences more in line with the scope of their alleged misconduct, and reduce pressure on state prosecutors to wield hammer-like statutes like OCCA over criminal defendants in order to increase their sentencing exposure.

1. *People v. Kozlowski*, 11 N.Y.3d 223 (2008). The *Kozlowski* case involved corporate looting. The Martin Act has also been successfully applied in cases involving securities boiler room operations (e.g., A.R. Baron and D.H. Blair & Co.), a fraudulent financial planning institution, *People v. Sala*, 95 N.Y.2d 254 (2000), insider trading, *People v. Napolitano*, 282 A.D.2d 49 (1st Dept. 2001), perjury before the National Association of Securities Dealers, *People v. Cohen*, 187 Misc. 2d 117 (Sup. Ct. N.Y. County 2000), and stock price manipulation, *People v. Cohen*, 9 A.D.3d 71, 88-89 (1st Dept. 2004).

2. See New York County District Attorney's Office New Release available at http://manhattanda.org/whatsnew/press/2009-05-20.shtml. The authors of this article represented one of the witnesses in this case for a period of time.

3. See New York County District Attorney's Office News Release available at http://manhattanda.org/whatsnew/press/2009-03-03.shtml.