

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF RHODE ISLAND

SECURITIES AND EXCHANGE  
COMMISSION

v.

C.A. No. 02-154 ML

DENNIS S. HERULA, ET AL.

**MEMORANDUM AND ORDER**

This case is before the Court for written decision on the Securities and Exchange Commission's ("SEC") motion for entry of final judgment against defendant Dennis S. Herula ("Herula"). On Thursday October 10, 2002, the Court issued an oral decision granting the SEC's motion on the record and informed counsel that a written decision would follow. The facts as set forth in this Court's Memorandum and Order dated May 1, 2002, granting the SEC's motion for a preliminary injunction, are hereby incorporated into this decision and are the basis for this Court's finding that the relief set forth herein is appropriate.

**I. Procedural History**

The SEC filed its complaint in this matter on April 1, 2002, and filed an amended complaint on April 3, 2002, alleging that Herula, along with a number of other defendants including his wife, Mary Lee Capalbo ("Capalbo"), violated the anti-fraud provisions of the federal securities laws in connection with a sham "investment program" that involved the fraudulent offering of securities and the misappropriation of investor funds. Following the

SEC's filing of an emergency motion for a temporary restraining order ("TRO"), an order freezing the defendants' assets, and for other equitable relief, this Court granted the TRO ex parte on April 3, 2002. On April 23 and 24, 2002, the Court held an evidentiary hearing on the SEC's motion for a preliminary injunction and, on April 24, issued an oral decision granting the SEC's motion for a preliminary injunction and asset freeze as to a number of the defendants, including Herula. On May 1, 2002, the Court issued a Memorandum and Order detailing its oral decision of April 24, and on May 8, 2002, the Court issued a written Preliminary Injunction Order further describing the extent of the relief that had been granted to the SEC. For a comprehensive discussion of the facts in this case, the Court directs the reader to the May 1, 2002, Memorandum and Order.

Pursuant to Fed. R. Civ. P. 55(a), following both Herula and Capalbo's failure to file an answer to either the complaint or the amended complaint, and upon application by the SEC, on June 7, 2002, the Clerk of this Court entered a default against both defendants. The SEC moved for a default judgment against Herula and Capalbo on July 24, 2002. A hearing on the SEC's motion for default judgment was scheduled for August 29, 2002. Prior to that date, the defense moved for and received a two-week continuance, until September 9, 2002, in order to prepare to for the hearing. On September 9, 2002, defendants Herula and Capalbo filed an objection to the SEC's motion for entry of default judgment and, included in that objection, defendants moved to vacate the default. That objection was not timely. The Court denied defendants Herula and Capalbo's request to vacate the Clerk's default, and, despite the late filed motion in opposition to the SEC's motion for entry of final judgment, indicated that the Court would proceed with a hearing on the SEC's motion for entry of final judgment on September 16, 2002.

On September 16, 2002, defendant Herula, accompanied by counsel, was present for the hearing before the Court; defendant Capalbo was not. A hearing was held on the SEC's motion for entry of final judgment as to Herula. The SEC presented the testimony of an SEC investigator, Corliss Primavera, who had traced investor funds that had moved in and out of accounts controlled by Herula and Capalbo. Herula did not present any evidence.

In its motion the SEC requested that this Court enter final judgment as to Herula (1) permanently enjoining Herula from violating Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77(q)(a)] and Section 10-b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]; (2) ordering Herula to disgorge ill-gotten gains;<sup>1</sup> and (3) imposing a civil monetary penalty on Herula.<sup>2</sup>

## **II. Standard**

### *A. Permanent Injunction*

Once a defendant's liability for violations of the securities laws has been established, a permanent injunction against future violations of the securities laws may issue if the defendant's conduct indicates "that there is a reasonable likelihood of further violations in the future." SEC v. Deyon, 977 F. Supp. 510, 518-19 (D. Maine 1997), aff'd, 210 F.3d 428 (1<sup>st</sup> Cir. 1997) (citation omitted). In considering the likelihood of recurrence, courts may consider whether the defendant "has been found liable for illegal conduct; the degree of scienter involved; whether the infraction is an 'isolated occurrence;' whether defendant continues to maintain that his past conduct was

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<sup>1</sup> The SEC seeks judgment in the amount of \$20,669,532.70 plus prejudgment interest.

<sup>2</sup> This is the identical relief sought against Herula's wife and co-defendant, Mary Lee Capalbo (aka Mary Lee Capalbo Herula); that matter, however, has been continued until a later date and is not the subject of today's decision.

blameless; and whether, because of his professional occupation, the defendant might be in a position where future violations could be anticipated.” SEC v. Cavanagh, 155 F.3d 129, 135 (2<sup>nd</sup> Cir. 1998) (citing SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 100 (2<sup>nd</sup> Cir. 1978)); SEC v. Moran, 944 F. Supp. 286, 294 (S.D.N.Y. 1996) (stating same); SEC v. Ingoldsby, 1990 WL 120731, at \*2 (D. Mass May 15, 1990) (stating same).

B. *Disgorgement*

“Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws.” SEC v. First City Financial Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1989) (citation omitted). The actual dollar figure that a defendant may be required to disgorge “need only be a reasonable approximation of profits causally connected to the violation.” Id. at 1231-32. Once the SEC satisfies its burden of showing that its disgorgement figure reasonably approximates the amount of unjust enrichment, the defendant is then obliged “to [clearly] demonstrate that the disgorgement figure is not a reasonable approximation.” Id. at 1232. It is within a court’s discretion to assess prejudgment interest on amounts that the defendant is required to disgorge. Moran, 944 F. Supp. at 295. “Requiring payment of interest prevents a defendant from obtaining the benefit of what amounts to an interest free loan procured as a result of illegal activity.” Id. The rate established by the Internal Revenue Service for tax underpayment is an appropriate rate for prejudgment interest because “that rate reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from [his] fraud.” SEC v. First Jersey Securities, 101 F.3d 1450, 1476 (3<sup>rd</sup> Cir. 1996).

*C. Civil Monetary Penalty*

Where, as here, the violation committed by the defendant involves “fraud, deceit, manipulation, or deliberate disregard of a regulatory requirement; and . . . such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons,” Section 20(d)(2)(C) of the Securities Act of 1933 [15 U.S.C. § 77(t)(d)(2)(C)] and Section 21(d)(3)(B)(iii) [15 U.S.C. § 78u(d)(3)(B)(iii)] of the Securities Exchange Act of 1934 authorize the imposition of monetary penalties up to the greater of \$100,000 for each violation or the defendant’s gross pecuniary gain as a result of the violation, which, in this case, is in the millions of dollars.

**III. Discussion**

Based on the findings of fact made by this Court in its Memorandum and Order dated May 1, 2002, and incorporated herein, Herula is liable for violating Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77(q)(a)] and Section 10-b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

It is unnecessary to engage in a protracted discussion of the appropriateness of entering a permanent injunction against Herula in this case. Not only is it likely that future violations of the securities laws will occur if Herula is not permanently enjoined, it appears that similar violations have already occurred. Undeterred by this Court’s entry of a preliminary injunction admonishing him to keep his hands off of other people’s money, Herula, no sooner than the ink had dried on this Court’s order, lined his pockets with funds from another fraudulent scheme that allegedly netted approximately \$40,000,000. As a result, Herula is now the subject of securities fraud action that is pending in the United States District Court for the Northern District of California.

Allowing this defendant to continue to ply his trade would be the equivalent of allowing the fox to guard the henhouse. Accordingly, for the reasons listed herein and set forth in additional detail in this Court's Memorandum and Order dated May 1, 2002, the Court finds that a permanent injunction is an appropriate remedy in this case.

The testimony of the SEC investigator in support of the SEC's motion for final judgment was not refuted by Herula. That testimony established that of the \$20,669,532.70 that was invested with the various defendants in this action, \$16,733,520.83 had come under the direct control of defendants Herula and Capalbo, and \$8,731,776.95 could actually be traced to their personal accounts. The Court finds that the appropriate disgorgement liability in this case is the amount of investor funds that the SEC has shown were under Herula's control: \$16,733,520.83. When \$2,208,144.80 in prejudgment interest is added to that figure, Herula's total disgorgement liability comes to \$18,941,665.63.

In light of the foregoing, the Court also finds that a monetary penalty is appropriate. The loss to investors in this case is staggering, and it is uncertain when, if ever, their money will be returned. While the victims in this case have spent the past months scrambling to effect a return of their money, Herula has seen fit to spend it as fast as he possibly could. He and his wife purchased an assortment of luxury items including jewelry, art, cars, trips, and expensive meals. This type of egregious conduct warrants a harsh monetary penalty. Accordingly, the Court orders Herula to pay a \$250,000 civil penalty.

#### **IV. Conclusion**

For the foregoing reasons, the SEC's motion for entry of final judgment against defendant Dennis Herula is GRANTED. Defendant Dennis Herula is hereby permanently restrained and

enjoined from violating or aiding and abetting violations of Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77(q)(a)] and Section 10-b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]. Defendant Dennis Herula shall be liable for disgorgement of \$16,733,520.83, plus prejudgment interest thereon in the amount of \$2,208,144.80 for a total of \$18,941,665.63. The disgorgement payment shall be made within thirty (30) days from the date of this ORDER. The payment shall be made by money order, certified check or cashier's check made payable to Clerk, United States District Court and shall be mailed to the Clerk of the Court with a cover letter identifying the name of this action and the docket number. A copy of the letter shall be mailed to Martin F. Healy, Securities and Exchange Commission, 73 Tremont Street, Boston MA 02108.

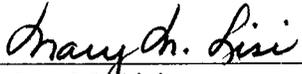
With respect to the SEC's request for the imposition of a civil monetary penalty pursuant to Section 20(d)(2)(C) of the Securities Act of 1933 [15 U.S.C. § 77(t)(d)(2)(C)] and Section 21(d)(3)(B)(iii) [15 U.S.C. § 78u(d)(3)(B)(iii)] of the Securities Exchange Act of 1934, a penalty in the amount of \$250,000 shall be imposed against defendant Dennis Herula. The payment shall be made within thirty (30) days from the date of this ORDER. The payment shall be made by money order, certified check or cashier's check made payable to the United States Securities and Exchange Commission. The payment shall be transmitted to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 0-3, Washington, D.C. 20549 with a cover letter identifying the name and docket number of this action. A copy of the letter shall be mailed to Martin F. Healey, Securities and Exchange Commission, 73 Tremont Street, Boston, MA 02108.

This Court shall retain jurisdiction over defendant Dennis Herula as a party to this matter

for all purposes, including the implementation and enforcement of this judgment.

The Clerk of the Court is directed to enter this JUDGMENT forthwith.

SO ORDERED:



Mary M. Lisi  
United States District Judge  
October 17, 2002