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Sutherland Annual Study Finds That It Sometimes Pays to Litigate Against FINRA (formerly NASD)

Broker-dealer firms that litigated saw great success Study questions “settlement discount”

Washington, DC (May 12, 2008) – Sutherland Asbill & Brennan LLP announced that it has completed its fourth annual analysis of litigated disciplinary proceedings brought by the Financial Industry Regulatory Authority (FINRA, formerly NASD) against broker-dealer firms and registered representatives. The study, authored by partner Brian L. Rubin and associate Christian J. Cannon, analyzes cases from January 2007 to December 2007 where the self-regulatory organization charged respondents with violating NASD and Securities and Exchange Commission (SEC) rules and statutes. The study also compares 2007 results with prior years.

Rubin, former Deputy Chief Counsel of Enforcement for FINRA’s predecessor, stated: “Many firms and registered representatives fear litigating against FINRA because its staff has often spent months or even years investigating the conduct. It is also well-funded, with its own procedural rules, and every Hearing Panel is headed by a FINRA employee. Respondents fear that ‘the house that the regulators built’ gives FINRA a home field advantage. Our studies have shown that it often pays for member firms and registered representatives to litigate, rather than settle.”

The study also calls into question the so-called “settlement discount,” presenting evidence that, based on the available data, the sanctions imposed by Hearing Panels are usually not more severe than the terms offered if the firm or representative settles prior to trial. Cannon, a former registered representative, points out, “The staff commonly negotiates by stating that they will seek and obtain a harsher sanction at the hearing if the respondent refuses to settle. But this claim is often hollow. The staff does not always seek a harsher penalty and, in any event, the Hearing Panel does not always award the sanction sought by the staff.”

The Results of the Study

Trials

FINRA disciplinary proceedings begin when a complaint is filed, and culminate in a trial before a Hearing Panel with two current or former industry members and one Hearing Officer, who is a FINRA employee. The Hearing Officer serves as Chair of the Hearing Panel and oversees the proceedings with authority to make all rulings about the schedule, the procedures, and what evidence will be admitted. The Hearing Officer also writes the decision of the Panel.

The study found the following regarding Hearing Panel decisions during 2007, and how they compared with other years:

Liability

- Of the 72 charges that were litigated during 2007, firms and representatives were successful in getting 11% of the charges dismissed by the Hearing Panel. This statistic is similar to the previous seven years (2000-2006).
- Resources appear to have an impact on the success of the respondents.
 - Broker-dealer firms, which presumably have more resources than individuals and often retain counsel, were far more likely to succeed than individuals. In 2007, approximately 29% of the charges against firms were dismissed, compared with approximately 5% for individuals. In 2006, the difference was even starker: approximately 44% of charges were dismissed against firms, while individuals were successful only approximately 6% of the time.
 - Similarly, respondents who have resources to hire counsel are overwhelmingly more successful. In 2007, respondents represented by counsel succeeded in getting approximately 17% of charges dismissed, while respondents who litigated without the benefit of counsel succeeded in getting only approximately 3% of charges dismissed. In 2006, retaining counsel made an even bigger difference. Respondents represented by counsel succeeded in getting approximately 13% of charges dismissed while pro se respondents struck out every time.
- The staff was unusually successful in convincing Hearing Panels that respondents committed a fraud in 2007—liability was found in all nine instances where fraud was alleged. In contrast, during the previous seven years, respondents were successful in beating fraud charges approximately 25% of the time, meaning that fraud charges were more than twice as likely to be dismissed as other charges.
- Respondents are sometimes successful in preventing FINRA from publicizing their liability. In general, decisions imposing a fine of less than \$10,000 and no suspension or bar are published in “redacted” form and do not identify the respondents. During 2007, approximately 14% of respondents were able to “win” a redacted decision, a rate comparable to 2006.

Sanctions

- Where respondents lost on liability, approximately 50% of the time they were successful convincing the Hearing Panel to order a lower monetary sanction than that demanded by FINRA staff. When this happened, fines were reduced on average from approximately \$16,000 sought to \$6,000 awarded. In 2006, where respondents lost on liability, they were more successful in getting a lower monetary sanction. That happened approximately 74% of the time. The amount of reduction in 2007 was similar to prior years.
- In 2007, the Hearing Panel ordered higher fines than requested by FINRA staff approximately 33% of the time. In contrast, in 2006, there were no cases where monetary sanctions sought by the staff were increased.
- When respondents lost on liability, approximately 52% of the time they were successful convincing the Hearing Panel to order a lower suspension sanction than that demanded by FINRA. Similarly, in 2006, respondents were successful approximately 45% of the time.

- When the staff sought a suspension, respondents convinced the Hearing Panel to reduce it approximately 58% of the time, which is about the same as in 2006. In those circumstances, the 2007 Hearing Panels reduced the suspension by 55%, from approximately 7.8 months sought to 3.6 months ordered. In 2006 that figure was 63%, from approximately 9.2 months sought to 3.4 months ordered.
- When the staff sought a complete bar from the industry, respondents convinced the Hearing Panel to order a lesser sanction approximately 46% of the time, which is about the same as in 2006. When reduced, the Hearing Panel ordered a suspension of 16.5 months (compared with 10.3 months in 2006).

Appeals to the National Adjudicatory Council (NAC)

After the Hearing Panel trials, appeals are heard by the NAC, which is composed of representatives of member firms and the public. FINRA staff or the respondent may appeal; alternatively, the NAC may decide on its own to review a case. The study made the following findings regarding NAC decisions:

- Respondents faced long odds on appeal. In 2007, respondents were unsuccessful approximately 81% of the time. Approximately 19% of appeals resulted in increased sanctions, while the sanctions were affirmed approximately 62% of the time. Interestingly, all of the 2007 appeals that resulted in increased sanctions were initiated by the respondent. During 2006, the percentage of losses by respondents on appeal was even higher: 92% of appeals resulted in affirmed or increased sanctions.
- Over the past two years, every time the NAC has increased suspension sanctions ordered by the Hearing Panel (which happened to 12.5% of respondents whose appeals were decided during 2006-07), it has imposed a bar.

Appeals to the SEC and Federal Courts of Appeals

Respondents who are unsuccessful before the NAC have the right to appeal to the SEC, and from there to the appropriate Federal Court of Appeals. The study made the following findings:

- In 2007, 72% of SEC appeals were either dismissed without briefing or were affirmed. The remaining 28% were reversed or remanded to the NAC for further findings. In 2006, 38% were reversed or remanded.
- During 2007, only one FINRA/NASD disciplinary appeal was decided in the federal courts. It was a success for the respondent because it remanded the case to the SEC to reduce or justify the sanctions imposed.
- During 2006, only one FINRA/NASD disciplinary appeal was decided in the federal courts. It affirmed an SEC order enforcing monetary sanctions against a respondent.

The “Settlement Discount”

“Settlement discount” is a phrase often used to convince another party to settle, rather than litigate. After FINRA investigations, if the staff has determined to recommend that charges be brought against a respondent, the staff normally offers to settle prior to filing a complaint and litigating. According to conventional wisdom, the sanctions proposed as part of a settlement are less severe than the sanction that would be sought and presumably imposed at the hearing. In theory, this provides an incentive to settle rather than litigate.

Sutherland surveyed 20 counsel who litigated against FINRA during December 2006 through December 2007 to determine whether there is, in fact, a settlement discount. Responses were received by six counsel, who defended six respondents against nine charges brought by FINRA. While the sample may not be representative, the results are interesting. Of those who responded, 33% stated that the staff did not seek more severe sanctions at the hearing than it had offered in pre-hearing settlement negotiations. This indicates that in 33% of the cases the staff did not offer a “settlement discount.” Although this could be interpreted as suggesting that the staff viewed the settlement offer as fair and did not want to propose a sanction that could not be defended to the Hearing Panel, it does not suggest that there is a “discount” for settling early. In approximately 83% of the cases, the Hearing Panel ordered sanctions that were equal to or less severe than those sought by the staff during settlement negotiations. While these figures could be statistical anomalies, they nevertheless serve as evidence that a settlement discount may not exist because the staff’s proposed settlement terms may be too harsh. If respondents know that the sanctions they risk by litigating are usually not worse than the proposed settlement sanctions, they may choose to litigate even in cases where liability is all but a foregone conclusion, which is an unnecessary expenditure of resources for all parties. Since FINRA has access to all settlement offers in all cases, it may want to study this issue carefully and determine whether its settlement offers are fair and are inducing appropriate settlements.

Other Benefits from Litigating

Litigating a case may take months or years to resolve. Some respondents prefer settling to avoid these delays and to put the matter behind them. Others choose to litigate to clear their name, while taking advantage of the fact that they can typically work and earn a living while the litigation is pending. During 2007, the time between the filing of the complaint and the rendering of the Hearing Panel decision averaged 15 months. This was comparable to 2006.

Appeals similarly take a substantial amount of time. While appeals to the NAC are pending, the Hearing Panel decision is stayed and a respondent can therefore continue to work. NAC appeals in 2007 took approximately 17 months to resolve, about the same as in 2006. SEC appeals, which stay the effectiveness of any FINRA-imposed sanction except for a bar or expulsion, took approximately 11 ½ months during 2007, about five weeks longer than in 2006. Thus, the time between the filing of a complaint and the issuance of an SEC decision (based on the 2007 figures) averages out to approximately 3 years and 7 ½ months. Unfortunately for respondents, an appeal to the appropriate federal court does not operate as an automatic stay of the sanction imposed by the SEC.

About the Study

The study reviewed 31 Hearing Panel decisions from 2007, involving 42 respondents and 73 total charges—and compared those results with the previous seven years (2000-2006), including the 40 decisions litigated during 2006, which involved 47 respondents and 89 total charges. In addition, the study reviewed 28 appellate decisions by the NAC addressing the cases of 31 respondents, and 11 SEC decisions addressing the appeals of 18 respondents. The analysis of these appeals was compared with a similar analysis of the prior years.

This year’s study is a follow-up on previous studies by Rubin and Cannon. In May 2005, they authored an article entitled “The House That the Regulators Built: An Analysis of Whether Respondents Should Litigate Against NASD,” published in BNA’s *Securities Regulation & Litigation Report*. That study, which analyzed litigated cases brought by NASD from 2000 through 2004, won the 2006 Burton Award for Legal Achievement. It is available by clicking [here](#). Rubin and Cannon also conducted an analysis of litigated proceedings from January 2005 through December 2005. Those results were published in a May 2006 article entitled “The House That the Regulators Built (Revisited): An Analysis of Whether Respondents Should Litigate Against NASD,” published in BNA’s *Securities Regulation & Litigation Report*, available by clicking [here](#). Last year, Rubin and Cannon conducted an analysis of litigated proceedings from January 2006 through June 2007, the results of which were published in the November 2007 issue of *Securities Litigation Report*, available by clicking [here](#).

Rubin and Cannon are part of Sutherland's securities regulatory, enforcement and white collar practice group, which is one of the nation's top practices in this field. Its attorneys include former senior attorneys of the U.S. Securities and Exchange Commission, NASD, the Department of Justice and financial service providers. The Sutherland team provides a full range of services, including advice and support during compliance and regulatory examinations, internal investigations, defense and guidance during civil and/or criminal investigations, and defense of litigation (including appeals) in self-regulatory, administrative, civil, and criminal enforcement proceedings, and trials.

About Sutherland

Sutherland Asbill & Brennan LLP is an Am Law 100 law firm known for solving challenging business problems and resolving unique legal issues for many of the world's largest companies. Founded in 1924, the firm has grown to more than 500 lawyers with offices in Atlanta, Austin, Houston, New York, Tallahassee and Washington. Please visit www.sutherland.com.

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