

Sutherland Annual Study Finds that it Sometimes Pays for Broker-Dealers and Registered Representatives to Litigate Against the SEC and FINRA (formerly NASD)

Broker-dealer firms that litigated saw great success

By Brian L. Rubin and Christian J. Cannon

SUMMARY

Sutherland Asbill & Brennan LLP has completed its annual analysis of litigated disciplinary proceedings brought by the U.S. Securities and Exchange Commission (SEC) and 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 October 2007 through September 2008 where firms and individuals were charged with violating SEC and NASD rules and statutes.

Rubin, former Deputy Chief Counsel of Enforcement for FINRA's predecessor and former Senior Counsel with the SEC, stated: "Many firms and registered representatives fear litigating against regulators because the staff has often spent months or even years investigating the conduct. They are well-funded, with their own procedural rules, and an employee of the agency often serves as a judge. Respondents fear that 'the house that the regulators built' gives the SEC and FINRA a home field advantage. Our studies have shown that it often pays for broker-dealers and registered reps to litigate, rather than settle."

Both the SEC and FINRA have jurisdiction to bring enforcement cases against broker-dealers and their registered representatives. FINRA was created in July 2007 through the consolidation of NASD and NYSE Member Regulation. According to FINRA, it oversees nearly 5,000 brokerage firms and approximately 665,000 registered securities representatives.

THE RESULTS OF THE STUDY

Trials

SEC administrative enforcement proceedings begin with the SEC's Department of Enforcement filing a complaint, called an Order Instituting Proceedings (OIP). The cases are tried before an SEC Administrative Law Judge (ALJ), who is independent of the Commission. The ALJ issues an initial decision that includes findings of fact, legal conclusions and, at times, a sanction.

FINRA disciplinary proceedings begin when the Department of Enforcement or the Department of Market Regulation file a complaint, 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, making rulings about the schedule, the procedures, and what evidence will be admitted. The Hearing Officer also writes the decision of the Panel.

Complaints and OIPs include one or more "charges" alleging a violation of a rule or statute. The study found the following regarding SEC initial decisions and Hearing Panel decisions during the period covered by the study:

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Liability

- Of the 86 charges that were litigated by the SEC and FINRA during the year ended September 30, 2008 (the SEC's fiscal year), firms and representatives succeeded in getting charges dismissed 16% of the time. SEC respondents had slightly more success (approximately 19%—5 of 26) than FINRA respondents (15%—9 of 60). The success that FINRA respondents had marked an improvement compared with prior years going back to January 2000. Historically, the average dismissal rate for FINRA charges has hovered around 11%.
- 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. Approximately 45% of FINRA charges against firms were dismissed,¹ while only approximately 8% of the charges against individuals were dismissed.² In comparison, for FINRA cases from January 2006 through December 2007, approximately 35% of the charges against firms were dismissed,³ compared with approximately 6% for individuals.⁴ Interestingly, firms rarely litigate against the SEC. Only two firms did so during the past three fiscal years; one lost on liability, and the other did not contest liability.
 - Similarly, respondents who have resources to hire counsel are overwhelmingly more successful than those that do not. SEC respondents represented by counsel succeeded in getting approximately 22% of charges dismissed,⁵ while FINRA respondents represented by counsel succeeded in getting approximately 19% of charges dismissed.⁶ SEC and FINRA respondents without counsel, on the other hand, went 0-for-16. From January 2006 through December 2007, no pro se SEC respondent succeeded in getting a charge dismissed. During that same two-year period, FINRA respondents represented by counsel succeeded in getting approximately 14% of charges dismissed,⁷ while respondents who litigated without the benefit of counsel succeeded in getting only approximately 2% of charges dismissed.⁸
- Fraud charges are generally more difficult for the staff to win because the regulators need to prove that the respondents acted with bad intent. SEC and FINRA staff failed to prove fraud approximately 28% of the time (22% for the SEC;⁹ 33% for FINRA¹⁰).
- When the SEC brings an enforcement action, the decision is always made public. FINRA, on the other hand, generally does not publicly identify respondents where the fine is less than \$10,000 and no suspension or bar is imposed. Approximately 11% of FINRA respondents were able to "win" a redacted decision.¹¹

Sanctions

This section analyzes only those cases where the decisions indicate a specific sanction sought by the staff.

- **Monetary Sanctions** – When SEC and FINRA respondents were found to have violated one or more charges, approximately 60% of the time (12 of 20 respondents) the ALJ or Hearing Panel imposed lower monetary sanctions than those sought by the staff.
 - SEC respondents convinced ALJs to impose lower monetary sanctions approximately 83% of the time.¹² When sanctions were lowered, the proposed penalties ranged from \$325,000 to nearly \$1.4 million, while the amount ordered ranged from \$0 to \$500,000. The average proposed penalty was approximately \$750,000, while the amount ordered averaged approximately \$245,000 (a reduction of approximately 67%). During the prior two years, the proposed monetary penalty was reduced every time.

- FINRA respondents convinced Hearing Panels to reduce the proposed monetary sanction approximately 50% of the time.¹³ When fines were reduced, the proposed fine ranged from \$5,000 to \$65,000 and averaged approximately \$25,000. The amount ordered ranged from \$1,000 to \$35,000 and averaged approximately \$13,000 (a reduction of approximately 47%). During calendar years 2006 to 2007, FINRA respondents convinced Hearing Panels to reduce the proposed fine approximately 65% of the time. In those cases, the proposed fines averaged \$20,000 while the imposed fines averaged \$6,000 (a reduction of 70%).
- It was rare that the adjudicator ordered higher monetary sanctions. During the past three fiscal years, SEC ALJs never ordered a higher monetary penalty. For FINRA cases, during the year ended September 30, 2008, 20% of the time, Hearing Panels ordered fines greater than those requested by FINRA staff. When increased, the average fine at least doubled. During calendar years 2000 to 2007, for approximately 10% of the respondents,¹⁴ Hearing Panels ordered higher fines than the FINRA staff requested. Those fines increased by approximately 43%.
- **Time Out from the Industry** – When SEC and FINRA respondents lost on liability, they convinced the adjudicators to order a suspension from the securities industry which was less than that sought by the staff approximately 39% of the time (15 of 38).
 - When the SEC staff asked for a suspension or a permanent bar from the industry, approximately 19% of the time,¹⁵ respondents succeeded in convincing the ALJ to order a sanction less than that demanded.
 - FINRA respondents were far more effective, succeeding approximately 55% of the time.¹⁶ In calendar years 2000 to 2007, FINRA respondents were successful approximately 44% of the time.
 - When FINRA staff sought a suspension of a set amount of time (as opposed to a complete bar), respondents convinced the Hearing Panel to reduce it approximately 79% of the time,¹⁷ When the requested suspension sanctions were reduced, they were reduced by approximately 78%, from 11.3 months sought to 2.5 months ordered. In calendar years 2006 to 2007, respondents were successful approximately 58% of the time. In those cases, Hearing Panels reduced the suspension by approximately 63%, from 17.8 months sought to 6.6 months ordered.
 - When FINRA staff sought a complete bar from the industry, only one of eight respondents convinced a Hearing Panel to impose a lesser sanction. In contrast, during calendar years 2006 to 2007, respondents convinced the Hearing Panel to order a suspension of less than a bar approximately 46% of the time.

Initial Appeals

SEC ALJ initial decisions can be appealed to the Commission by either the respondent or by the Division of Enforcement. Alternatively, the Commission may, on its own initiative, order a review of any initial decision. Appeals are heard by the SEC Chairman and the SEC Commissioners. For FINRA disciplinary actions, after the Hearing Panel trials, appeals are heard by the National Adjudicatory Council (or NAC), which is composed of representatives of member firms and the public. FINRA Enforcement or Market Regulation 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 initial appeals:

SEC

- When respondents appealed ALJ decisions to the SEC, approximately 43% were successful in getting reduced sanctions.¹⁸ During the prior fiscal year, there were four appeals by respondents, one of which resulted in a complete dismissal while the others were affirmed. In addition, Enforcement appealed one case that had been dismissed by the ALJ; the SEC reversed and found liability.

FINRA

- FINRA respondents faced long odds on appeal. Sanctions were reduced for respondents approximately 30% of the time.¹⁹ The NAC increased sanctions for approximately 7% of the respondents and affirmed the sanctions approximately 63% of the time. In calendar years 2006 to 2007, approximately 91% of appeals resulted in affirmed or increased sanctions.

FINRA Respondents' Appeals to the SEC, and FINRA/SEC Respondents' Appeals to the U.S. Courts of Appeals

FINRA respondents who are unsuccessful before the NAC have the right to appeal to the SEC, and from there to the U.S. Court of Appeals. SEC respondents may likewise appeal to the U.S. Court of Appeals. The study made the following findings:

- Approximately 74% of respondents' appeals of NAC decisions to the SEC were either dismissed without briefing or resulted in affirmed sanctions.²⁰ In the remaining 26% of cases, the SEC either reduced the charges and remanded for sanctions, or simply ordered reduced sanctions.
- Only one FINRA disciplinary appeal was decided in the federal courts, and it affirmed the SEC.
- Only two respondents appealed SEC administrative decisions to the federal courts of appeals, resulting in one affirmance and one denial of the review.

The Time Advantage of 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 names, while taking advantage of the fact that they can typically work and earn a living while the litigation is pending. The time between the filing of the OIP and the ALJ Initial Decision averaged just under 8 months. For FINRA matters, the time between the filing of the complaint and the rendering of the Hearing Panel decision averaged approximately 15 months.

Appeals similarly take a substantial amount of time. While appeals to the NAC are pending, the Hearing Panel decisions are stayed and respondents can therefore continue to work. NAC appeals took approximately 17 months to resolve. Appeals to the SEC, which stay the effectiveness of any FINRA-imposed sanction except for a bar or expulsion, took approximately 12.8 months. Thus, for FINRA respondents, the time between the filing of a complaint and the issuance of an SEC decision averages approximately 3 years and 9 months. Unfortunately for respondents, an appeal to the appropriate federal court of appeals does not operate as an automatic stay of the sanction imposed by the SEC.

ABOUT THE STUDY

The study reviewed 14 SEC ALJ decisions issued between October 1, 2007, and September 30, 2008, involving 18 respondents and 30 total charges, and 3 Commission decisions issued during that period with respect to 7 respondents and 10 charges.

In addition, the study reviewed 29 FINRA Hearing Panel decisions issued between October 1, 2007, and September 30, 2008, involving 36 respondents and 60 total charges. Also analyzed were results from January 2000 forward, with particular focus on the 71 decisions litigated during calendar years 2006 to 2007, which involved 89 respondents and 162 total charges. The study also reviewed 20 appellate decisions by the NAC addressing the cases of 27 respondents, and 14 SEC decisions addressing the appeals of 19 FINRA respondents. The analysis of these appeals was compared with a similar analysis of prior years.

This year's study is a follow-up on previous studies conducted by Rubin and Cannon. Their first study, titled "The House That the Regulators Built: An Analysis of Whether Respondents Should Litigate Against NASD," was published in BNA's May 2005 Securities Regulation & Litigation Report, and won the 2006 Burton Award for Legal Achievement. It is available at http://www.sutherland.com/file_upload/bna.pdf.

ABOUT THE AUTHORS



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Brian L. Rubin and Christian J. 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 companies. 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 475 lawyers with offices in Atlanta, Austin, Houston, New York, and Washington. Please visit www.sutherland.com.

¹ 5 of 11.

² 4 of 49.

³ 9 of 26.

⁴ 8 of 135.

⁵ 5 of 23.

⁶ 9 of 47.

⁷ 16 of 114.

⁸ 1 of 47.

⁹ 2 of 9.

¹⁰ 3 of 9.

¹¹ 4 of 36.

¹² 5 of 6.

¹³ 7 of 14.

¹⁴ 13 of 124.

¹⁵ 3 of 16.

¹⁶ 12 of 22.

¹⁷ 11 of 14.

¹⁸ 3 of 7.

¹⁹ 8 of 27.

²⁰ 14 of 19.