D.C. CIRCUIT OPINIONS CALL INTO QUESTION FINRA'S ABILITY TO IMPOSE "CAPITAL PUNISHMENT" ON THE SECURITIES INDUSTRY

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The D.C. Circuit on October 13, 2017, issued an order remanding to the SEC a question involving an application of the Supreme Court's recent decision in *Kokesh v. SEC*: whether FINRA's imposition of a lifetime bar on a registered representative is properly considered "punitive." [1] Although the controlling opinion itself does not contain any binding discussion of Kokesh in this context, two members of the Court's panel issued separate opinions expressing their (divergent) views on this question. This issue is now before the SEC and, if appealed, will present an opportunity for the D.C. Circuit to address this question, which could have wide-ranging impact on FINRA and SEC practice for charging and sanctioning individual members of the securities industry.

THE D.C. CIRCUIT ORDER

Over the span of ten years, John M.E. Saad has lived through a FINRA disciplinary hearing, an appeal to the National Adjudicatory Council ("NAC"), an appeal to the SEC, an appeal to the D.C. Circuit, a partial remand from the D.C. Circuit to the SEC (in 2013), [2] a second NAC decision, a second appeal to the SEC, a second appeal to the D.C. Circuit, and now, a second partial remand from the D.C. Circuit to the SEC. Underlying it all is a lifetime ban from the securities industry imposed on Mr. Saad by a FINRA hearing panel, upon concluding that Mr. Saad submitted several false expense claims to his employer and subsequently attempted to conceal his misconduct.

In 2013, the D.C. Circuit remanded the case only because the SEC's analysis failed to address potentially mitigating evidence, such as Mr. Saad's termination by his employer, which occurred prior to regulatory detection, and Mr. Saad's personal and professional stress. Left open was the question of whether the lifetime bar was an "excessive or oppressive" sanction.

On remand, the SEC directed the NAC to reconsider the imposition of the lifetime bar and to address various mitigating factors. The NAC determined that the lifetime bar was an appropriate remedy for Mr. Saad's misconduct and, on the record before it, found that no relevant mitigating factors existed. The SEC affirmed, after considering both aggravating and mitigating factors and concluding the record before it supported FINRA's imposition of a lifetime bar. The SEC further determined that the lifetime bar is "'remedial, not punitive,' and 'necessary to protect FINRA members, their customers, and other securities industry participants[.]'"

In its recent decision, the D.C. Circuit held that the SEC's "thoroughgoing decision directly addressed the mitigating evidence, as required by our prior remand order, and provided a careful and comprehensive analysis of Saad's arguments seeking a reduction in his sanction." As to the question of whether the SEC's affirmance of the

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lifetime bar is impermissibly punitive, however, the D.C. Circuit remanded that question to the SEC to address the relevance, if any, of the Supreme Court's recent decision in *Kokesh*.

THE SUPREME COURT'S KOKESH DECISION

In *Kokesh v. SEC*, [3] the Supreme Court held that disgorgement ordered in securities enforcement actions is subject to the five-year statute of limitations under 28 U.S.C. § 2462, which applies in any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." In that case, investment adviser Charles Kokesh was found liable for misappropriating funds from his clients and was ordered to pay $34.9 million in disgorgement. The issue before the Supreme Court was whether the disgorgement order was considered a "penalty" under Section 2462. Writing for a unanimous Court, Justice Sonia Sotomayor held that the disgorgement order was punitive rather than remedial because "[i]t is imposed as a consequence of violating a public law and it is intended to deter, not to compensate."

Kokesh did not address whether other SEC sanctions, such as bars or suspensions, should also be considered penalties and thus subject to Section 2462's statute of limitations.

JUDGE KAVANAUGH INVOKES KOKESH IN EVALUATING FINRA SANCTIONS

In addition to the controlling opinion, Circuit Judge Brett Kavanaugh issued a separate concurring opinion that raises the question of how *Kokesh* impacts whether the lifetime bar imposed against Mr. Saad is deemed an impermissible penalty. In his view, *Kokesh* controls this question and bars, suspensions, and expulsions should accordingly be viewed as penalties.

Judge Kavanaugh explained that, under existing D.C. Circuit precedent, an order approving FINRA sanctions such as expulsion or a bar must be remedial, not punitive. These cases analyzed the statute governing SEC review of disciplinary actions by self-regulatory organizations ("SROs"), which provides that the SEC, "having due regard for the public interest and the protection of investors" must find that the sanction does not impose any burden on competition not "necessary or appropriate" in furtherance of the securities laws or that is "excessive or oppressive." [4] These prior cases have determined that a challenged SRO order "may impose sanctions for a remedial purpose, but not for punishment."

Judge Kavanaugh cast doubt as to whether *Kokesh* upends the decisions finding expulsions or suspensions to be remedial. In his opinion, the *Kokesh* decision is not limited to disgorgement; rather, because sanctions such as bars and suspensions (like disgorgement) "do not provide a remedy to the victim," they are properly characterized as a "penalty." Indeed, he noted that prior D.C. Circuit opinions have characterized a lifetime bar as "the securities industry equivalent of capital punishment."

Judge Kavanaugh made clear that he was not suggesting that, under his application of *Kokesh*, FINRA would lack the power to impose expulsions or suspensions as punitive sanctions. Instead, such sanctions could be imposed, but would need to be characterized and evaluated as a punishment (not a remedy). Thus, "FINRA and the SEC will have to reasonably explain in each individual case why an expulsion or suspension serves the purposes of punishment and is not excessive or oppressive," which might, over time, result in "a fairer, more equitable, and less arbitrary system of FINRA and SEC sanctions."

JUDGE MILLETT'S "GRAVE DOUBTS" THAT KOKESH APPLIES

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Circuit Judge Patricia Millett, on the other hand, filed a separate *dubitante* opinion, expressing her "grave doubts" about the position taken by Judge Kavanaugh and arguing that *Kokesh* in fact has no relevance in this area.

Judge Millett pointed out several distinctions between the two actions, including that they involved "different remedial schemes and materially different statutory standards." Whereas *Kokesh* resolved the question of whether an SEC order of disgorgement based on violations of federal securities laws constituted a "penalty," the review in *Saad* concerned the SEC's exercise of discretionary superintendence over the decisions of a private self-regulatory organization to ensure its disciplinary decisions do not impose burdens "not necessary or appropriate" and not "excessive or oppressive." Further, the Supreme Court's reasoning for why disgorgement was not "remedial" (that such payments do not protect or compensate victims) does not apply to FINRA bars, which she explained are intended to protect the industry and its investors from bad actors. Thus, she disagreed with Judge Kavanaugh that *Kokesh* upended any prior D.C. Circuit decisions, and instead cited that same precedent as evidence for her contention that "the Commission may approve expulsion not as a penalty but as a means of protecting investors."

Judge Millett explained that the foundational premise of Judge Kavanaugh's opinion was that it (wrongly) conflated "remedial" with "compensatory." In her view, a sanction can be remedial even if it does not provide a remedy to the victim, noting precedent that a remedial sanction can be preventative. As she explained, the debarment order against Mr. Saad directly remedied the harms he caused, noting: "Ordering the fox out of the henhouse falls comfortably within the common understanding of the term 'remedial.'"

KEY TAKE-AWAYS

Although the D.C. Circuit's decision in *Saad* has no immediate binding impact on these issues, it represents another potentially interesting outgrowth of *Kokesh* and may provide a means by which individuals and firms could challenge a FINRA order of bar, expulsion, or suspension. It also may provide further reasoning for why a bar or suspension should be considered a penalty for purposes of the five-year statute of limitations in Section 2462.

As this issue develops further on remand and in other venues, the circumstances under which suspensions and bars are imposed may also change. Judge Kavanaugh predicted that FINRA and the SEC could still use such tools, but that they would need to justify any such "punitive" sanction in individual cases. As he noted, previous decisions have held that, under the securities laws, FINRA bars may only be imposed for a remedial purpose, not for punishment. Therefore, if Judge Kavanaugh's position is embraced by a later court, those precedents might need to be considered and, potentially, overturned in order for bars and suspensions to survive.

Despite the legal limbo of the *Saad* case, the debate between Judges Kavanaugh and Millett provides another interesting take on the impact of *Kokesh*. Practitioners and regulators may want to take note of and consider the issues raised in the *Saad* case in connection with future disciplinary actions.

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[1] *Saad v. SEC*, No. 15-1430, 2017 WL 4557511, at *5–6 (D.C. Cir. Oct. 13, 2017).

[2] *Saad v. SEC*, 718 F.3d 904 (D.C. Cir. 2013).

[3] 581 U.S. __, 137 S. Ct. 1635 (2017).

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[4] 15 U.S.C. § 78s(e)(2).

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