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400 – How to Negotiate a Settlement with the SEC

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Faculty Biographies

Deborah Heilizer

Deborah Heilizer, a member of Sutherland's securities enforcement, litigation and regulation team, focuses her practice on accounting and financial issues, regulatory enforcement, and litigation involving the U.S. Securities and Exchange Commission (SEC), self-regulatory organizations and private litigants. She also represents public companies and regulated entities, including broker-dealers, investment advisers and individuals in a wide range of securities matters, including state and federal regulatory matters, disclosure issues and compliance matters.

Prior to joining the firm, Ms. Heilizer was in-house counsel at the retail brokerage division of a large financial institution, where she handled litigation and regulatory matters. For more than a decade, she also worked at the SEC's division of enforcement conducting and supervising investigations involving potential violations of the federal securities laws.

Ms. Heilizer received her BA from University of Chicago and her JD, cum laude, from Northwestern University School of Law.

Christopher Laia

Christopher P. Laia is senior vice president of enterprise compliance and ethics and is responsible for ensuring USAA sustains its commitment to the highest standards of ethics and business conduct, and continues to comply with all applicable laws and regulations.

Prior to this role, he was vice president and general counsel for the USAA financial advice and solutions group, which provides life insurance and annuities, mutual funds and brokerage and financial advisory services to USAA's members. Prior to joining USAA, he served as general counsel for Brown Advisory, and the chief compliance officer and lead counsel to Deutsche Bank Alex Brown. He also worked at the United States Securities and Exchange Commission as a branch chief and staff attorney in the enforcement division.

Mr. Laia is a member of the New York Bar Association and the Society of Corporate Compliance & Ethics. He serves as a board member of AVANCE-San Antonio, a group that works with low income families and communities to promote better parenting developing stability in families; school readiness and literacy of children of all ages; and health and personal development promoting economic self-sufficiency.

Mr. Laia holds a BA in political science from the State University of New York at Stoney Brook, his JD from Willamette University College of Law in Salem, OR, and a LLM from Tulane University School of Law in New Orleans, LA. He holds the series 7, 9, 10

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and 24 with the Financial Industry Regulatory Authority. He is also a Certified Compliance & Ethics Professional.

Brian Rubin

Brian Rubin, a member of Sutherland's litigation practice group, represents broker-dealers, investment advisers, investment companies, public companies and individuals being examined, investigated and prosecuted by the U.S. Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), other self-regulatory organizations and states. He also conducts internal investigations, defends clients in litigation and arbitration, and provides regulatory and compliance counseling. Mr. Rubin has been named to The Best Lawyers in America in securities litigation and in securities regulation and selected as a Washington, D.C., Super Lawyer® in securities litigation.

Before joining Sutherland, Mr. Rubin was deputy chief counsel with the NASD's enforcement department, where he managed attorneys and examiners in the Washington, D.C., home office and in the district offices. He received the prestigious Excellence in Service Award for outstanding commitment and superior performance in support of NASD, as well as the NASD President's Award for outstanding performance and dedicated service. Previously, Mr. Rubin was senior counsel in the SEC's division of enforcement.

Mr. Rubin currently serves on the board of advisors at the Securities and Exchange Commission Historical Society, the editorial board of the *Journal of Securities Law, Regulation & Compliance*, the editorial advisory board of *Practical Compliance and Risk Management* for the securities industry, and the editorial board of the *Journal of Investment Compliance*.

Mr. Rubin received his BS, cum laude from University of Pennsylvania and a joint JD and MA from Duke University.

Peter Schneider

Peter W. Schneider is executive vice president, general counsel, corporate secretary and chief administrative officer of Primerica, Inc. He has responsibility for the office of the general counsel, which provides the company with legal counsel and covers the areas of litigation (claims/policyholder and non-claims), field legal support, unfair competition, field investigations, business counsel, government relations, compliance, field audit, human resources and other administrative support functions.

As outside counsel at the Atlanta law firm of Rogers & Hardin, he represented not only Primerica and Primerica Life, but also handled matters for Citigroup, Salomon Smith Barney, Shearson, Travelers, Citifinancial and National Benefit Life.

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He worked at the law firm of Paul, Weiss, Rifkind, Wharton & Garrison as an associate and at the law firm of Rogers & Hardin, where he became a partner and a member of the firm's Management Committee. Mr. Schneider serves on the boards of directors of the Georgia Chamber of Commerce, the Direct Selling Association (DSA), the Northwest North Carolina YMCA and the Carolina Center for Jewish Studies. He also co-chairs the American Council of Life Insurance's producer licensing task force.

Mr. Schneider earned his BS (with highest honors) in political science and industrial relations and was a member of several academic honorary societies including Phi Beta Kappa. He earned his JD (with high honors) from the University of North Carolina at Chapel Hill and served as an editor of the North Carolina Law Review.

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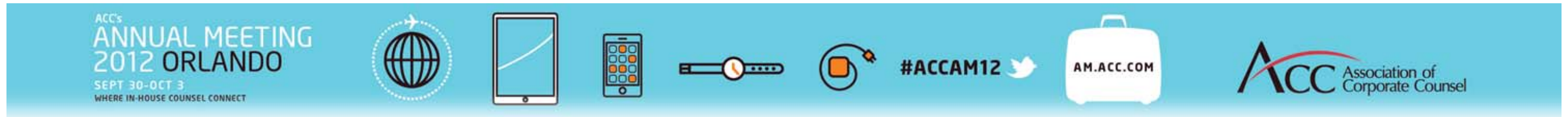

How to Negotiate a Settlement with the SEC

Christopher P. Laia, Senior VP, Enterprise Compliance & Ethics – USAA
Peter W. Schneider, Executive VP, General Counsel – Primerica
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Introduction

- Background
- The story you are about to hear …

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Cast of Characters

Name	Role
Peter Schnieder	GC for ABCD, Inc.
Brian Rubin	Partner, Dewey, Huey, and Louie Counsel for ABCD, Cindy Rella & Michael Mouse
Chris Laia	Assistant Deputy Associate Chief, SEC Enforcement
Deb Heilizer	Principal Associate Chief Assistant, SEC Enforcement
Anonymous	Jenn McCricket, Whistleblower
Other Parties	Wally Dizne, ABCD CFO Michael Mouse, ABCD In-House Counsel Cindy Rella, ABCD President and CEO

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Blowing the Whistle

- Misstated income for 4 years
- Improper accruals or reserves in books and records; later reversal of some reserves
- Net income incorrect by total of $20 million
- Dizney, CFO, spoke with Mouse, in-house counsel
- CEO/President, Rella, signed public filings

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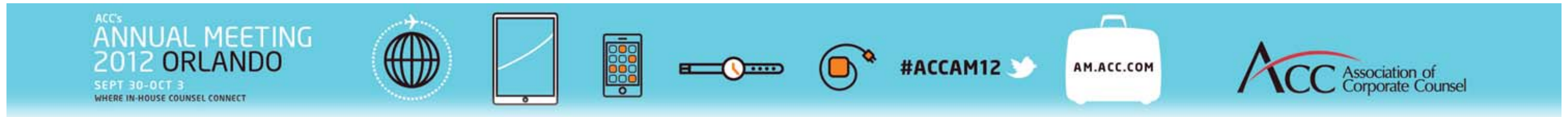

SEC Reaction to Self-Reporting: What Do We Have Here?

SEC Meeting #1

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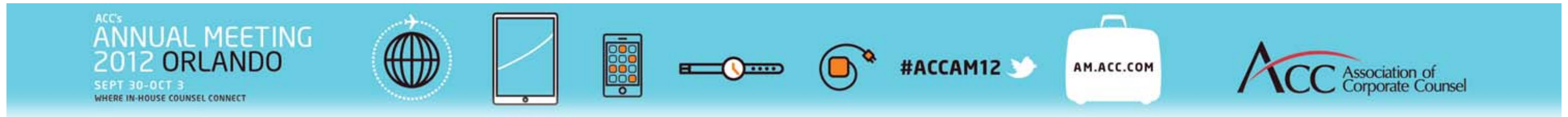

The Subpoena Has Landed: What Do We Do?

ABCD In-House Counsel and Outside Counsel Meeting #1

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SEC Completes Its Investigation: Here Comes the Wells Call

- SEC’s concerns
- Wells call:
  - Injunctive action
  - Company’s potential violations:
    - Section 10(b) of Exchange Act, Rule 10b-5 and Section 17(a) of Securities Act
    - Section 13(a) of Exchange Act (reporting violation)
    - Section 13(b)(2) of Exchange Act (record keeping and internal control violations)
  - Aiding and abetting the company’s violations by Dizne, Mouse and Rella

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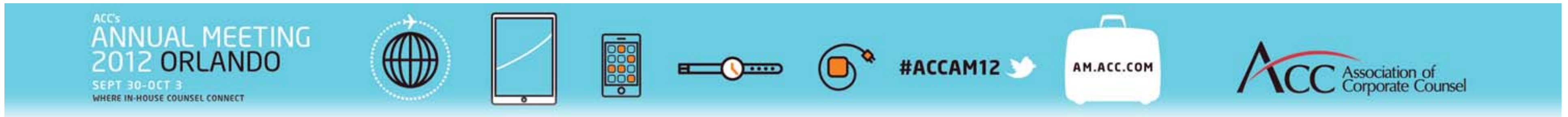

Proposed Defendants: What Did We Get Ourselves Into?

ABCD In-House and Outside Counsel

Meeting #2

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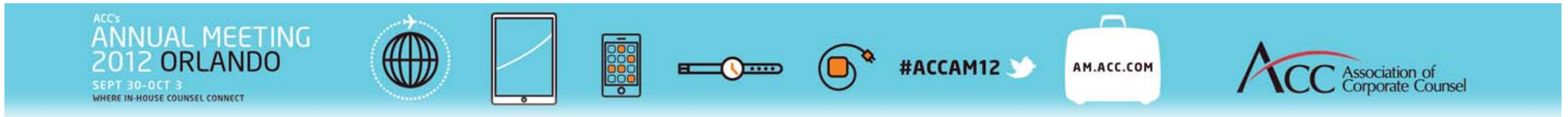

The Negotiation

Both Sides Meet, Part 1

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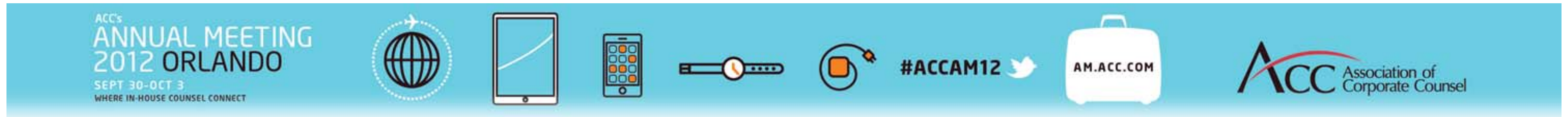

SEC:
Time to Compromise

SEC Meeting #2

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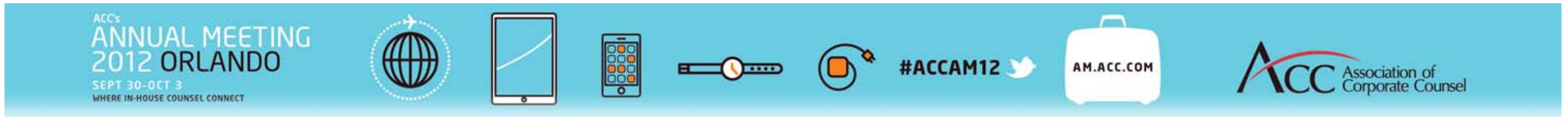

Defendants: Time to Compromise

ABCD GC and Outside Counsel
Meeting #3

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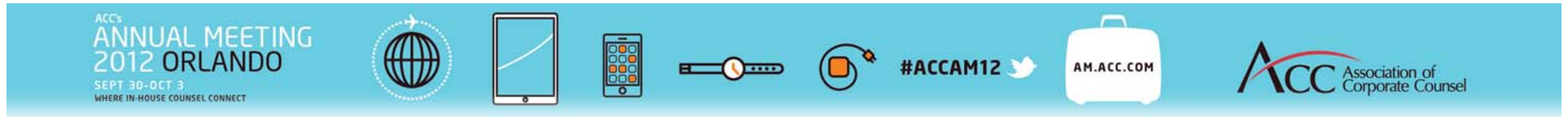

Final Settlement:
No One Goes Away Happy

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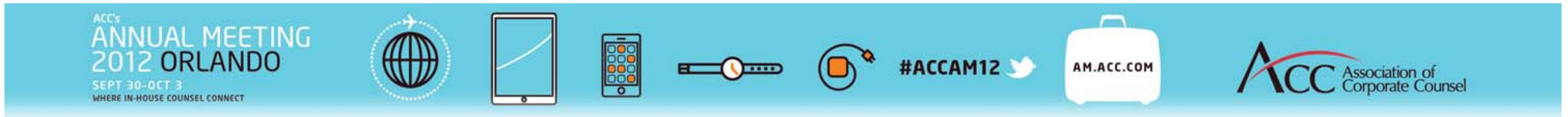

Epilogue

The Moral of the Story

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Clawbacks: How Far Will the SEC Go to Recapture Executive Compensation?

By Neil Lang and Jae Yoon

In April 2012, the U.S. Securities and Exchange Commission (SEC) filed an action in federal district court against two former executives of ArthroCare Corporation. The SEC was seeking to recover bonuses and stock sale profits under Section 304 of the Sarbanes-Oxley Act (SOX), which requires CEOs and CFOs to return certain compensation if a company restates its financial statements for misconduct or material noncompliance with financial reporting laws. A few months earlier, the former CEO of Symmetry Medical Inc. agreed to return $450,000 under Section 304 although the SEC did not allege that the executive had violated any other provision of the securities laws, or even that he was aware of the misconduct leading to the company's restated financial statements.

These developments demonstrate the SEC's continued willingness to hold members of the executive suite financially accountable for corporate misconduct, even when it cannot prove substantive violations. Thus, protestations of "it's not my job" and "I had no knowledge of the misconduct" may be insufficient when the executive benefitted from erroneous financial statements.

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Indeed, the Director of the SEC's Division of Enforcement stated that the possibility of clawbacks under Section 304 "is yet another reason for CEOs and CFOs to be vigilant in preventing misconduct and requiring that companies comply with financial reporting laws."[1] If the SEC applied Section 304 in each case involving restated financials, the potential ramifications would be quite serious. However, enforcement actions and cases to date indicate that the SEC is not in fact applying a one-size-fits-all approach to imposing strict liability.

Clawbacks Under the Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) also expanded the scope of clawbacks. Whereas Section 304 of SOX requires reimbursement from CEOs and CFOs for restatements resulting from "misconduct," Section 954 of the Dodd-Frank Act expands the reimbursement requirement to include all executive officers for restatements resulting from "material noncompliance with any financial reporting requirement."

Although the Dodd-Frank Act expands the reimbursement requirement and the group of persons potentially required to reimburse compensation, the amount which must be reimbursed may be greater or less than that required under Section 304, depending on the facts. Under Section 304, all incentive-based compensation and stock profits earned during the 12 months following the issuance of the erroneous financial statement must be returned. Meanwhile, under the Dodd-Frank Act, the executive must return only the compensation paid in excess of what should have been paid under the corrected financial statements over the three-year period preceding the date the company is required to file a restatement.

Strict Liability Under Section 304

Under Section 304 of SOX, unless exempted by the SEC, CEOs and CFOs are required to return any bonus, any incentive-based or equity-based compensation and all stock sale profits obtained during the 12-month period following a financial statement later restated "as a result of misconduct." In July 2009, the SEC first took the position that it could clawback compensation from an executive who was not alleged to have participated in, or even have had specific knowledge of, corporate misconduct.

In a federal district court action against Maynard Jenkins, the former CEO of CSK Auto Corporation, the SEC acknowledged that its complaint was "the first action seeking reimbursement under Section 304 from an individual who is not alleged to have otherwise violated the securities laws."[2] Despite its admittedly novel application of Section 304, the SEC survived a motion to dismiss filed by Jenkins by successfully arguing to the federal district court that the obligation to return compensation does not require a finding of personal misconduct on the part of the CEO or CFO. In November 2011, the federal district court approved a settlement pursuant to which Jenkins agreed to return approximately $2.8 million in bonus compensation and stock sale profits. The Director of the SEC's Division of Enforcement stated that "CEOs should know that they can be deprived of bonuses or stock profits they received while accounting fraud was occurring on their watch. . . ."[3]

Since filing the Jenkins complaint, the SEC has recovered compensation from four other executives not alleged to have violated any other provision of the securities laws and currently is litigating an action in federal district court against two executives. A brief summary follows below.

- In June 2010, the former CEO of Diebold, Inc., agreed to return $470,016 in cash, 30,000 shares and 85,000 stock options pursuant to a settlement with the SEC.
- In March and August of 2011, the SEC entered into settlements with the CEO and CFO of Beazer Homes USA Inc. The CEO agreed to reimburse the

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company $6,479,281 in cash (representing his cash bonuses and stock sale profits) and nearly 120,000 shares of restricted stock. Additionally, the CFO agreed to reimburse the company $1,431,022 in cash, representing his cash bonuses and stock sale profits, and the value of restricted stock.

- In February 2012, the former CEO of Symmetry Medical Inc., agreed to reimburse the company $450,000.
- In April 2012, the SEC filed an action in federal district court against the former CEO and the former CFO of ArthroCare Corporation, seeking to recover bonuses and stock sale profits.

In each of these cases, the SEC was explicit that it was not alleging personal involvement of the executive in the misconduct leading to the restatement of the company's financials or any other violation.

Targeted Application of Strict Liability

The SEC has recovered large clawbacks since 2009, and its continued use of Section 304 indicates that it still believes imposing strict liability under Section 304 is a viable tool in enforcement actions. However, the SEC has not sought to apply Section 304 in every case involving restated financials. Notably, the SEC has sought reimbursement only from six executives since taking the position that Section 304 does not require a showing of culpable involvement. The facts of the cases in which the SEC asserts strict liability provide insight into why the SEC sought return of compensation in those particular instances.

Firstly, misstatements were significant, either in terms of dollar value or relative to the company's income for that period. The Form 10-K filed in May 2003 by CSK Auto Corporation overstated pre-tax income by 47%; the April 2004 Form 10-K turned a pre-tax loss of $18 million into income of $16 million; and the May 2005 Form 10-K overstated pre-tax income by 65%. With respect to Diebold, "Diebold's improper, and in many instances fraudulent, accounting practices misstated the company's reported pre-tax earnings by at least $127 million." And, in the case of ArthroCare, the SEC alleged in its complaint that the net revenues reported by the company in three filings were overstated by 7.9%, 14.1% and 17.4%. The SEC also alleged that the company's net income as originally reported in its 2007 10-K was overstated by 8,694.3%.

Secondly, the misconduct was pervasive. The SEC alleged that "Diebold regularly manipulated earnings to meet forecasts." As a result, "Diebold filed at least 40 annual, quarterly, and current reports with the Commission, and issued dozens of press releases, that contained material misstatements and omissions concerning the company's financial performance." In addition, the Jenkins complaint states that CSK Auto Corporation filed two separate restatements, the second after a special investigation that uncovered further problems.

Finally, other senior executives at the companies were alleged to have violated the securities laws. The SEC alleged in filings in the Jenkins action that "senior members of CSK's management—including its chief financial officer, chief operating officer, controller, and director of credit receivables—were engaged in pervasive

Cases with Strict Liability

Considering that the SEC has not imposed strict liability under Section 304 in every case of restated financials, the SEC's enforcement actions indicate targeted application. The cases in which the SEC asserts strict liability involve the following:

- Significant misstatements, either in terms of dollar value or relative to the company's income for that period;
- Pervasive misconduct; and
- Involvement of other senior executives at the companies in allegedly violating the securities laws.

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accounting fraud . . . ." The SEC filed actions against the CFO, Controller and Director of Corporate Accounting of Diebold, Inc., alleging that they engaged in fraudulent accounting practice to inflate earnings. The case against Symmetry Medical Inc. allegedly involved "fraud [that] was orchestrated and carried out by senior executives and accounting staff . . . ."

Section 20(a) Liability

Around the same time the Jenkins action was filed, the SEC sought to impose strict liability upon two executives not charged with violating any provision of the securities laws by arguing that, under Section 20(a) of the Securities Exchange Act of 1934 (Exchange Act), they were liable for corporate misconduct because of their status as control persons.[4] Despite not alleging substantive violations by the executives, the facts of the cases support the conclusion that the SEC will apply Section 20(a) on a theory of strict liability in limited circumstances. Since obtaining consent judgments from these executives in the summer of 2009, the SEC has not filed or settled another action asserting strict control person liability.

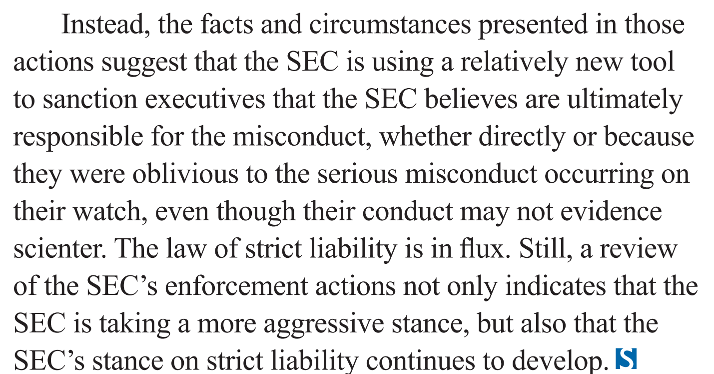
In July 2009, the SEC obtained consent judgments against the CEO and CFO of Nature's Sunshine Products, Inc., (NSP) enjoining them from violations of the Exchange Act and requiring each to pay a civil penalty of $25,000. In a complaint filed in federal district court against NSP, the CEO and the CFO, the SEC alleged that NSP violated the Foreign Corrupt Practices Act, committed securities fraud, made false filings with the SEC and failed to keep and maintain accurate books and records.[5] Notably, the SEC did not allege that either executive personally violated or aided and abetted the company's violations, or even that they knew of the illegal activities. However, the complaint does suggest that, had they adequately performed their supervisory duties and created an adequate system for preparing financial statements, the misconduct could have been prevented.

"The law of strict liability is in flux."

One reason for the SEC's decision not to bring more actions on a theory of strict liability might be the statutory inclusion of an apparent exception for control persons who acted in good faith and who did not induce the misconduct. The federal courts have not reached a consensus on the degree of culpability necessary to impose control person liability.[6] Therefore, as a matter of law and a matter of discretion, the SEC may refrain from asserting Section 20(a) liability unless it can allege that an executive had some involvement in the misconduct or did nothing to prevent violations of the law.

Continued Development

The enforcement actions described above reflect the SEC's willingness to bring actions under theories of strict liability against executives who are not alleged to have been involved in conduct leading to financial restatements. However, these actions do not suggest that the SEC will impose strict liability upon any and all executives and control persons.



Instead, the facts and circumstances presented in those actions suggest that the SEC is using a relatively new tool to sanction executives that the SEC believes are ultimately responsible for the misconduct, whether directly or because they were oblivious to the serious misconduct occurring on their watch, even though their conduct may not evidence scienter. The law of strict liability is in flux. Still, a review of the SEC's enforcement actions not only indicates that the SEC is taking a more aggressive stance, but also that the SEC's stance on strict liability continues to develop.

1. SEC. (Apr. 2, 2012). SEC Sues Two Executives in Texas to Recover Bonuses and Stock Profits Received During Accounting Fraud [Press Release No. 2012-51]. Retrieved from http://www.sec.gov/news/press/2012/2012-51.htm.
2. SEC. (July 22, 2009). SEC Seeks Return of $4 Million in Bonuses and Stock Sale Profits From Former CEO of CSK Auto Corp. [Press Release No. 2009-167]. Retrieved from http://www.sec.gov/news/press/2009/2009-167.htm.
3. SEC. (Nov. 15, 2011). Former CEO to Return $2.8 Million in Bonuses and Stock Profits Received During CSK Auto Accounting Fraud [Press Release No. 2011-243]. Retrieved from http://www.sec.gov/news/press/2011/2011-243.htm.
4. The Dodd-Frank Act recently resolved a split among the circuit courts as to whether the SEC can allege control person under Section 20(a) of the Exchange Act by explicitly providing the SEC the authority to do so.
5. NSP consented to entry of a judgment imposing an injunction against further violations and a civil penalty of $600,000.
6. Compare *Alki Partners, L.P. v. Vatas Holding GmbH*, 769 F. Supp. 2d 478 (S.D.N.Y. 2011) with *Lustgraf v. Behrens*, 619 F.3d 867 (8th Cir. 2010).

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Sutherland Study on Litigating Against the SEC and FINRA Shows It Sometimes Pays for Broker-Dealers and Registered Representatives to Take on the Regulators

By Brian L. Rubin and Jae C. Yoon
July 30, 2012

Whenever firms and individuals are faced with Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA, formerly NASD) investigations and enforcement actions, the question is raised about whether it is better to settle or litigate. For the past several years, Sutherland Asbill & Brennan LLP (Sutherland) has conducted studies analyzing this issue. This year's study shows that it sometimes pays to litigate, rather than to settle.

Since 2005, Sutherland has conducted a study of litigated disciplinary proceedings brought by FINRA against broker-dealers (BDs), registered representatives and associated persons. Since 2008, Sutherland also has analyzed administrative proceedings brought by the SEC against those same types of respondents. This year's study analyzes cases from October 2010 through March 2012 (the "Study Period") where BDs and individuals were charged with violating SEC and FINRA statutes, rules and regulations. The Study Period coincides with the SEC's 2011 fiscal year and the first half of the 2012 fiscal year.

Many BDs, registered representatives and associated persons fear litigating against regulators because the staff has often spent months or even years investigating the conduct. The SEC and FINRA are well-funded, with their own procedural rules, and the hearing officers are closely associated with the regulators. Respondents fear that "the house that the regulators built"[1] gives the SEC and FINRA a "home field" advantage. However, the Sutherland studies have shown that it sometimes pays for BDs and individuals to litigate, rather than to settle.

Both the SEC and FINRA have jurisdiction to bring enforcement cases against BDs, registered representatives and associated persons. FINRA was created in July 2007 through the consolidation of NASD and NYSE Member Regulation. According to FINRA, it oversees approximately 4,400 brokerage firms and approximately 630,000 registered representatives.

The Results of the Study

I. Trials

SEC administrative enforcement proceedings begin with the SEC's Division 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 but who hears the cases pursuant to authority delegated by the Commission itself. After a hearing, the ALJ issues an initial decision that includes findings of fact, legal conclusions and, at times, a sanction.

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[1] Sutherland's first study was titled "The House That the Regulators Built: An Analysis of Whether Respondents Should Litigate Against NASD." It 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.

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A FINRA disciplinary proceeding begins when the Department of Enforcement or the Department of Market Regulation files a complaint, and culminates in a hearing 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 FINRA Hearing Panel decisions:

A. Liability

Of the 126 charges that were litigated by the SEC and FINRA and resulted in SEC initial decisions or FINRA Hearing Panel decisions during the Study Period, BDs and individuals succeeded in getting 12.7% of the charges dismissed.[2]

1. *SEC Respondents*

Only seven respondents litigated against the SEC during the Study Period, and none convinced the ALJ to dismiss any charges.

2. *FINRA Respondents*

These respondents succeeded in getting 14.3% of the charges dismissed,[3] nearly double the success rate of respondents during Fiscal Year (FY) 2009 and FY 2010 (7.6%).[4]

3. *Representation by Counsel in FINRA Proceedings*

FINRA respondents with counsel are significantly more successful than *pro se* respondents. FINRA respondents represented by counsel succeeded in getting 18.8% of charges dismissed.[5] FINRA respondents without counsel, on the other hand, went 0-for-27 during the period. Since January 2006, only one *pro se* FINRA respondent has succeeded in getting any charge dismissed.

B. Fraud Charges

During the Study Period, SEC staff successfully proved all three of the fraud charges brought. FINRA staff failed to prove more than 22% of its fraud charges.[6] This is far less than its success rate for charges generally. In FY 2009-2010, FINRA staff succeeded in proving all of its fraud charges (five fraud charges against four respondents).

[2] 16 of 126.

[3] 16 of 112.

[4] FY 2009 refers to October 1, 2008 to September 30, 2009; FY 2010 refers to October 1, 2009 to September 30, 2010.

[5] 16 of 85.

[6] 7 of 9.

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C. FINRA Enforcement Priorities

Sutherland's annual survey on FINRA sanctions identified five categories of charges in which FINRA, in 2011, had obtained the greatest aggregate amount of fines through disciplinary actions.[7] Those categories were: advertising, auction rate securities, suitability, and improper form U4, U5 and Rule 3070 filings. An analysis of the litigated cases during the Study Period demonstrates that FINRA generally has had success in proving those categories of charges. FINRA staff succeeded in proving all five of its advertising charges and all nine charges relating to Forms U4 and U5. With respect to suitability, FINRA staff succeeded in proving three of five charges. However, FINRA successfully proved only one of four charges in its only case during the Study Period involving auction rate securities.

II. Sanctions

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

A. Monetary Sanctions

When SEC and FINRA respondents were found to be liable for one or more charges, 31.3% of the time, respondents convinced the ALJ or Hearing Panel to impose lower monetary sanctions than those sought by the staff.[8] Respondents in FY 2009-2010 had a similar rate of success (33%).[9]

1. *SEC Respondents*

These respondents convinced ALJs to impose lower monetary sanctions 28.6% of the time during the Study Period.[10] In contrast, in FY 2009-2010, ALJs lowered monetary sanctions approximately 50% of the time.[11]

2. *FINRA Respondents*

These respondents convinced Hearing Panels to reduce the proposed monetary sanction 33.3% of the time during the Study Period.[12] When fines were reduced, the proposed fine ranged from $15,000 to $30,000, and averaged $21,250. The amount ordered ranged from $5,000 to $20,000, and averaged $9,250 (a reduction of approximately 56%). FINRA respondents were more successful during the Study Period than during FY 2009-2010,[13] when their success rate was 27%.

[7] "Annual Sutherland FINRA Sanctions Survey Shows a 51% Jump in Fines in 2011," March 12, 2012, available at http://www.sutherland.com/newsevents/News_Detail.aspx?News=1276750e-5346-4135-bfc0-a7970d87db47.

[8] 5 of 16.

[9] 12 of 36.

[10] 2 of 7.

[11] 5 of 10.

[12] 3 of 9.

[13] 7 of 26.

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3. *Increase by Adjudicator*

As in FY 2009-2010, SEC ALJs never ordered a higher monetary penalty. Three FINRA Hearing Panels ordered fines greater than those requested by FINRA staff. In two instances, the Hearing panel doubled the fine. During FY 2009-2010, only one Hearing Panel ordered a higher fine (doubling the requested fine).

B. Suspensions From the Industry

When SEC and FINRA respondents lost on liability, they convinced the adjudicators 31.6% of the time to impose a suspension less than that sought by the staff. [14]

1. *SEC Respondents*

None of the seven SEC respondents succeeded in convincing the ALJ to order a sanction less than that sought by the SEC staff. In contrast, in FY 2009-2010, respondents were successful approximately 30% of the time.[15] However, during the Study Period, no ALJ imposed a higher sanction than was sought by SEC Staff.

2. *FINRA Respondents*

These respondents were more effective in reducing sanctions, succeeding approximately 50% of the time.[16] FINRA respondents were more effective recently than in FY 2009-2010, when they succeeded only 37% of the time.[17] In addition, 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 the suspension 37.5% of the time.[18] The Hearing Panel increased the suspension 25% of the time.[19] When FINRA staff sought a complete bar from the industry, 75% of respondents convinced a Hearing Panel to impose a lesser sanction.[20]

[14] 6 of 19.

[15] 3 of 10.

[16] 6 of 12.

[17] 14 of 38.

[18] 3 of 8.

[19] 2 of 8.

[20] 3 of 4.

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III. Initial Appeals

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

A. SEC

Six SEC respondents appealed and one respondent cross-appealed to the Commission. Of those, two respondents (or 28.6%) were successful in getting the charges against them dismissed, including the respondent who cross-appealed from the ALJ's initial decision.[21] Another respondent was successful in having his sanction reduced (from a complete bar to a bar with right to reapply after two years). The Commission increased the sanctions for three respondents, including in one instance where the SEC staff cross-appealed the ALJ decision. In contrast, in FY 2009-2010, no respondents succeeded in getting the charges dismissed, 33% were successful in getting reduced sanctions,[22] and sanctions were increased approximately 22% of the time.[23]

B. FINRA

No FINRA respondent was successful in having all findings of violations reversed, but approximately 11% were able to get one or more findings of violations reversed.[24] In contrast, in FY 2009-2010, 17% of respondents were successful in having all findings of violations reversed.[25] Although only 11% of FINRA respondents were able to obtain a reversal on at least one violation during the Study Period, 29.7% of respondents succeeded in obtaining reduced sanctions.[26] The NAC increased sanctions for 32.4% of the respondents.[27] In the eight cases where sanctions were increased, FINRA Enforcement staff appealed in one case and the NAC called the case for review in another.

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[21] Theodore W. Urban cross-appealed the decision of an ALJ which found that Urban (the general counsel of a broker-dealer during the relevant time) was a supervisor for purposes of liability under Sections 15(b)(4)(E) and 15(b)(6) of the Securities Exchange Act of 1934 despite also stating that Urban did not have the traditional powers of someone who supervised brokers. In the Matter of Theodore W. Urban, Admin. Proc. File No. 3-13655, Initial Decision Rel. No. 402 (Sept. 8, 2010), avail. at http://www.sec.gov/litigation/aljdec/2010/id402bpm.pdf. The ALJ ultimately dismissed the proceedings against him because the Division of Enforcement failed to establish that Urban's supervision of the rogue registered representative was not reasonable. After both sides appealed, the Commission dismissed the proceedings against Urban because the Commission was evenly split as to whether the OIP's allegations had been established. Admin Proc. File No. 3-13655; Rel. No. 34-66259 (Jan. 26, 2012), avail. at http://www.sec.gov/news/digest/2012/dig012612.htm. Furthermore, the initial decision of the ALJ was found to be of "no effect."

[22] 3 of 9.

[23] 2 of 9.

[24] 4 of 37.

[25] 6 of 36.

[26] 11 of 37.

[27] 12 of 37.

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IV. Further Appeals

SEC respondents may appeal to the U.S. Court of Appeals. When FINRA respondents are unsuccessful before the NAC, they have the right to appeal to the SEC, and from there, to the U.S. Court of Appeals.

A. Appeals to the U.S. Courts of Appeals

Nine respondents (five FINRA respondents and four SEC respondents) appealed SEC decisions to U.S. Courts of Appeals. The Courts of Appeals affirmed the decision of the SEC in all cases.

B. Appeals to the SEC

Approximately 82% of respondents' appeals of NAC decisions to the SEC were either dismissed without briefing or resulted in affirmed sanctions.[28] One respondent out of 22 obtained a complete dismissal,[29] one respondent was able to obtain reduced sanctions, and one respondent had his case remanded to FINRA for reconsideration of sanctions. Respondents thus had even less success than in FY 2009-2010, when approximately 70% of appeals were dismissed without briefing or resulted in affirmed sanctions.[30]

V. The Timing of Litigation

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.

A. Time for Trials

For SEC cases, the time between the filing of the OIP and the ALJ Initial Decision averaged just over 10.5 months. For FINRA matters, the time between the filing of the complaint and the rendering of the Hearing Panel decision averaged just over 14 months.

B. Time for Appeals

Appeals similarly take a substantial amount of time. With regard to FINRA cases, Hearing Panel decisions are stayed and respondents can therefore continue to work while appeals to the NAC are pending. NAC appeals took approximately 19 months to resolve. Appeals to the SEC, which stay the effectiveness of any FINRA-imposed sanction except for a bar or expulsion, took approximately 13 months. Thus, for FINRA respondents, the time between the filing of a complaint and the issuance of an

[28] 19 of 22.

[29] The Commission set aside the findings of violations and the sanctions imposed by FINRA against American Funds Distributors, Inc. (AFD) for allegedly engaging in directed brokerage payments. In the Matter of American Funds Distributors, Inc., Admin. Proc. File No. 3-13055 (June 24, 2011), avail. http://www.sec.gov/litigation/opinions/2011/34-64747.pdf. FINRA had previously obtained more than $50 million in settlements from over 20 firms for similar practices. *See* finra.org (search term "directed brokerage"). Rather than settle, AFD chose to litigate. Before the Hearing Panel, FINRA staff sought a $98 million fine against AFD. The Hearing Panel imposed a $5 million fine and censured AFD, and the NAC affirmed. AFD appealed to the Commission and, more than six years after the complaint was filed, succeeded in obtaining dismissal of the action.

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SEC decision averages approximately 3years and 10 months. Unfortunately, for SEC respondents, an appeal to the appropriate federal court of appeals does not operate as an automatic stay of the sanction imposed by the SEC. FINRA and SEC respondents who received decisions from the Court of Appeals during the Study Period waited on average 17 months from the date of the Commission's decision.

About the Study

The study reviewed three SEC ALJ decisions issued between October 1, 2010, and March 31, 2012, involving seven respondents and 14 total charges, and four Commission decisions issued during that period with respect to seven respondents and 12 charges.

In addition, the study reviewed 43 FINRA Hearing Panel decisions issued between October 1, 2010, and March 31, 2012, involving 49 respondents and 115 total charges. The study also reviewed 25 appellate decisions by the NAC addressing the cases of 37 respondents and 15 SEC decisions addressing the appeals of 22 FINRA respondents.

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