

The Need to Justify Sanctions as Remedial

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In *McCarthy v. SEC*, 406 F.3d, 179, 189-90 (2d Cir. 2005), a case in which Brunelle & Hadjickow, P.C. represented the accused, the SEC overturned as an "abuse of discretion" the suspension of a NYSE member, based on the SEC's failure to consider, and document, its consideration of all mitigating circumstances. At the same time, the Court emphasized that the SEC or a self-regulatory organization like the NYSE or FINRA could not lawfully impose a sanction merely to punish a rule violator, but could do so only upon demonstrating that the sanction would have a remedial purpose: "...[I]f the purpose of suspension was punitive, we would have little trouble upholding the two-year suspension on these grounds. But the Commission did not address the fact that McCarthy was a minor participant in the Oakford scheme whose action caused the trading public less harm than other members, his violations were of relatively short duration and ended in 1996, and by all accounts he has been lawfully trading ever since. Indeed, McCarthy has been trading on the floor of the Stock Exchange for the past 11 years (the two-year suspension was stayed pending appeal to the SEC and this Court), and the SEC does not dispute McCarthy's contention that, with the exception of his involvement with Oakford in 1995 and 1996, he has operated lawfully and within the rules. Thus, for nine years McCarthy has proven himself to be a rule-abiding trader. Even at the time the Board summarily imposed the two-year suspension, McCarthy had been trading without incident for six years.

"Moreover, the regulations prohibiting the activity in which McCarthy engaged, together with whatever ambiguities and uncertainties may have been present in 1996, have since been made clear. The entire billing process at the Stock Exchange has been reformed as a result. The Commission made no findings that would indicate any additional protection the trading public would receive, especially in light of the current regulatory climate, from the suspension of a trader who has operated successfully and lawfully for the past nine years. Since the SEC did not address the compelling facts in the record that suggest the sanction may be excessive and punitive, we have no basis from which to determine that the sanction was not arbitrary.

"To be sure, characteristics of the offense will often be relevant to remedial justifications for suspensions. The seriousness of the offense, the corresponding harm to the trading public, the potential gain to the broker for disobeying the rules, the potential for repetition in light of the current regulatory and enforcement regime, and the deterrent value to the offending broker and others are all relevant factors to be considered in deciding whether the sanction is appropriately remedial and not excessive and punitive. In this case, the record contains mitigating facts and circumstances from which a compelling argument can be made that suspending McCarthy now will not serve remedial interests and will work an excessive and punitive result—namely, the destruction of the brokerage practice McCarthy has built during several years of rule-abiding trading. We express no opinion on whether these circumstances in fact render the suspension irretrievably excessive and punitive, and we thus decline McCarthy's invitation to reverse the penalty outright. We do, however, believe that the Commission's decision simply to copy language from other cases—which merely recites general reasons why the challenged conduct is illegal—is not responsive to the mitigating facts and circumstances unique to this case, does not address the remedial and protective efficacy of the chosen sanction, does not provide a reasoned basis from which we can conclude that the decision is not arbitrary, and therefore constitutes an abuse of discretion."

The Second Circuit emphasized that "[a]lthough general deterrence is not, by itself, sufficient justification for expulsion or suspension...it may be considered as part of the overall remedial inquiry." *McCarthy*, 406 F.3d at 189. In other words, the SEC or an SRO cannot justify a suspension or expulsion exclusively on the theory that the action will deter others.

The necessity for a remedial, rather than an exclusively punitive, purpose for an order of suspension or expulsion has spread to the Court of Appeals for the District of Columbia in *PAZ Securities, Inc v. SEC*, 494 F.2d 1059, 1065-66 (D.C. Cir. 2007). This had the effect of extending the principle nationwide because, "A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia..." Section 25(a)(1) of the Exchange Act, 15 U.S.C. Sec. 78y(a)(1).

The PAZ Court adopted and applied the McCarthy ruling in a similarly comprehensive way, and in terms that made clear that the Courts of Appeals may hereafter take a more active role in reviewing SRO and SEC sanctions involving suspensions or expulsions: ". . .

[T]he petitioners claim the Commission failed to address several mitigating factors. Insofar as the petitioners claim the Commission should have considered their previously clean disciplinary record and that they did not attempt either to mislead anyone or to conceal their present misconduct, their arguments are forfeit because the petitioners did not raise them before the Commission. 15 U.S.C. Sec. 78y(c)(1). Insofar as the petitioners preserved other claims, however, they are on solid ground." In the course of emphasizing in its decision the petitioners' obligation to respond to the NASD's requests for information (the "NASD has a right to request information and require cooperation from those persons it

investigates"), the Commission mischaracterized the petitioners' argument, saying they "suggest[ed] that the information requests were not important because they focused on PAZ's supervisory procedures." In fact, their argument was not that the information sought was unimportant but rather that their failure to respond to the NASD (1) was of no potential monetary benefit to them and (2) did not result in any injury to the investing public, and that (3) the information requested did not relate to injurious conduct or conduct of potential monetary benefit to them." In addition, pursuant to Section 19 of the Act, the Commission was obliged-but failed-to review the sanction imposed by the NASD with "due regard for the public interest and the protection of investors." 15 U.S.C. Sec. 78s(e)(2). As the Second Circuit explained in *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940), that provision "authorizes [the Commission to order] expulsion not as a penalty but as a means of protecting investors.... The purpose of the order is remedial, not penal." If the Commission upholds the sanctions as remedial, then it must explain why; furthermore, "as the circumstances in a case suggesting that a sanction is excessive and inappropriately punitive become more evident, the Commission must provide a more detailed explanation linking the sanction imposed to those circumstances if it wishes to uphold the sanction." *McCarthy*, 406 F.3d at 190 . . ."