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## D.C. Circuit Holds that *Kokesh* Does Not Preclude Imposition of Industry Bars

In *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) (“*Kokesh*”), the Supreme Court of the United States held that disgorgement is a penalty and, therefore, any attempt by the U.S. Securities and Exchange Commission (“SEC” or “Commission”) to seek disgorgement is subject to 28 U.S.C. §2462, which sets forth a five-year statute of limitations that applies to the enforcement of penalties. The SEC has traditionally relied on its broad power to seek disgorgement to enforce the securities laws. After *Kokesh*, there was discussion that the decision would curtail or possibly eliminate the SEC’s ability to use disgorgement and other equitable remedies, such as industry bars.<sup>1</sup>

In *Saad v. SEC*, 2020 WL 6533465 (D.C. Cir. Nov. 6, 2020) (“*Saad v. SEC*”),<sup>2</sup> the Court of Appeals for the District of Columbia Circuit (“D.C. Circuit”) held, in a matter of first impression for the circuits, that *Kokesh* does not restrict the SEC’s ability to impose industry bars. The petitioner argued that, under *Kokesh*’s reasoning, industry bars are punitive and would constitute an impermissible sanction under Section 19(e)(2) of the Securities Exchange Act of 1934 (the “Exchange Act”). The D.C. Circuit rejected that argument, holding that *Kokesh* is limited to an interpretation of §2462 and does not apply to other statutory provisions, including Section 19(e)(2) of the Exchange Act. With this decision, the D.C. Circuit joins several circuits that have refused to apply *Kokesh* beyond §2462.

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### I. *Kokesh* and Open Questions as to Breadth

In *Kokesh*, the Supreme Court addressed whether disgorgement is a “penalty” under 28 U.S.C. §2462, which sets forth a five-year statute of limitations that applies to any “action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise.” Deciding that disgorgement was a penalty and not remedial, the Supreme Court established two principles to distinguish punitive from remedial sanctions. First, a punitive sanction or penalty “turns in part on whether the wrong sought to be redressed is a wrong to the public, or a wrong to the individual.” *Kokesh*, 137 S. Ct. at 1642. Second, a penalty is a sanction that is sought “for the purpose of punishment, and to deter others from offending in like manner—as opposed to compensating a victim for his loss.” *Id.*

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<sup>1</sup> See, e.g., *Supreme Court Holds That Five-Year Statute of Limitations Applies to SEC Disgorgement Actions* (June 12, 2017), available at <https://www.cahill.com/publications/firm-memoranda/2017-06-12-supreme-court-holds-that-five-year-statute-of-limitations-applies-to-sec-disgorgement-actions>.

<sup>2</sup> Unless otherwise specified, quoted statements in this memorandum are taken from this decision.

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Under these principles, the Supreme Court in *Kokesh* found that disgorgement was a penalty under §2462 because it is imposed for a wrong “committed against the United States rather than an aggrieved individual” and because “[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains.” *Id.* The Supreme Court highlighted that “SEC disgorgement is imposed for punitive purposes” and rejected the government’s argument that disgorgement is remedial, or operating to restore the status quo. *Id.* at 1643. “Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive because deterrence is not a legitimate nonpunitive governmental objective.” *Id.*

Following *Kokesh*, questions remained as to whether the Supreme Court’s distinction between penalties and remedial measures would apply outside of the §2462 context and, therefore, curtail or eliminate the SEC’s ability to impose certain types of equitable relief, such as industry bars. Several circuits have refused to apply *Kokesh* beyond the narrow statute of limitations context.<sup>3</sup> Until *Saad v. SEC*, however, no circuit court had directly addressed whether *Kokesh* applies to statutes involving industry bars or debarments.

In *Saad v. SEC*, an industry bar was issued by the Financial Industry Regulatory Authority (“FINRA”), a self-regulatory organization that provides oversight of broker-dealers. Under Section 19(e)(2) of the Exchange Act, the SEC may overturn or reduce a sanction imposed by FINRA for two reasons: if it finds that (i) the sanction “imposes any burden on competition not necessary or appropriate,” or (ii) the sanction is “excessive or oppressive.” 15 U.S.C. § 78s. A sanction that is penal or punitive, as opposed to remedial, is typically considered “excessive or oppressive” and would therefore be impermissible under the statute. See, e.g., *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005).

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## II. Factual and Procedural Background

John M.E. Saad (“Saad”) was a FINRA-registered broker-dealer at an affiliate of Penn Mutual Life Insurance Company (“Penn Mutual”) called Hornor, Townsend & Kent, Inc., a FINRA member firm. In July 2006, Saad was scheduled to go on a business trip from Atlanta to Memphis, but the trip was cancelled and he instead checked into an Atlanta hotel. Following the “trip,” Saad submitted false expense reports to his employer for air travel, his hotel stay, and drinks in the hotel lounge. He also submitted a false reimbursement for a replacement cellphone that he purchased for a potential Penn Mutual recruit. Penn Mutual’s office administrator discovered Saad’s misconduct, and Saad was fired.

FINRA investigated Saad, who repeatedly lied about his misconduct. In September 2007, FINRA brought a disciplinary proceeding against Saad for violation of FINRA Rule 2010 (at the time, NASD Rule 2110), which states that “[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.” The FINRA hearing panel imposed an industry bar, permanently banning Saad from associating with any FINRA member firm. Saad appealed the ruling pursuant to Section 19(e)(2) of the Exchange Act, which states that the SEC may review any disciplinary action or sanction taken by FINRA. 15 U.S.C. §78s(d)– (e). The SEC sustained the findings of FINRA, holding that “FINRA’s decision to bar Saad is neither excessive nor oppressive and that the sanction serves a remedial rather than punitive purpose.” In the Matter of the Application of John M.E. Saad for Review of Disciplinary Action Taken by FINRA, Release No. 62178 (May 26, 2010).

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<sup>3</sup> See, e.g., *United States v. Ellis*, 938 F.3d 757, 765 (6th Cir. 2019) (declining to apply *Kokesh* to restitution obligation under Mandatory Victims Restitution Act); *United States v. Dyer*, 908 F.3d 995, 1003 (6th Cir. 2018) (*Kokesh* analysis not applicable to Double Jeopardy Clause); *Jalbert v. SEC*, 945 F.3d 587, 591-592 (1st Cir. 2019) (declining to apply *Kokesh* to SEC’s statutory authority to seek disgorgement in administrative proceedings); *Fed. Trade Comm’n v. AMG Capital Mgmt., LLC*, 910 F.3d 417, 426-427 (9th Cir. 2018) (*Kokesh* not applicable to Federal Trade Commission’s authority to obtain restitution).

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Saad then petitioned the D.C. Circuit for review of the SEC's decision. The D.C. Circuit held that the SEC "abused its discretion when it affirmed FINRA's imposition of a lifetime bar" because it failed "to address several potentially mitigating factors," such as Saad's stress level and personal issues. *Saad v. SEC*, 718 F.3d 904, 912 (D.C. Cir. 2013). The case went back to FINRA to assess the mitigating factors. FINRA determined the industry bar was still warranted, and the SEC again affirmed.<sup>4</sup> Saad petitioned the D.C. Circuit for review for a second time, arguing that insufficient weight was given to mitigating factors and, in any event, that the industry bar was "impermissibly punitive rather than remedial." The D.C. Circuit held that while the SEC "reasonably balanced the relevant mitigating and aggravating factors before determining that the gravity of Saad's behavior warranted remedial action," the SEC also must consider whether *Kokesh* had any impact on the SEC's ability to impose a lifetime industry bar. *Saad v. SEC*, 873 F.3d 297, 302 (D.C. Cir. 2017). On remand, the Commission concluded that *Kokesh* had "no bearing on the determination that the FINRA disciplinary action should be sustained." In the Matter of the Application of John M.E. Saad for Review of Disciplinary Action Taken by FINRA, Release No. 86751 (Aug. 23, 2019). Saad again petitioned the D.C. Circuit for review of the SEC's order.

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### III. The D.C. Circuit Affirms the Industry Bar

Addressing the lifetime bar for a third time, the D.C. Circuit refused to extend *Kokesh*'s reasoning beyond §2462. First, the court explained that the Supreme Court in *Kokesh* expressly limited its holding to the narrow facts of its case — that is, to disgorgements under §2462. Second, the court observed that, under D.C. Circuit precedent, general principles for distinguishing between punitive and remedial sanctions do not exist. For example, the D.C. Circuit has concluded that a professional suspension is a penalty in a §2462 inquiry following a similar approach to that in *Kokesh*. See *Johnson v. SEC*, 87 F.3d 484, 491–92 (D.C. Cir. 1996). Yet, the D.C. Circuit also has held that a lifetime bar against a NASD member was remedial under §78s(e)(2) because the purpose of the bar was not to punish but to protect the public. See *PAZ Sec., Inc. v. SEC*, 566 F.3d 1172, 1175 (D.C. Cir. 2009). Third, the D.C. Circuit indicated that "Supreme Court precedent confirms that *Kokesh* has no bearing on the Exchange Act." In *Liu v. SEC*, 140 S. Ct. 1936 (2020), the Supreme Court held that disgorgement was permissible as equitable relief under Section 21(d)(5) of the Exchange Act, which "historically excludes punitive sanctions." "The [Supreme] Court declined to reflexively apply *Kokesh* and instead independently analyzed the meaning of 'remedial' within the separate set of cases relevant to the statutory inquiry."<sup>5</sup> Finally, the D.C. Circuit indicated that using *Kokesh* to prohibit debarments under the Exchange Act as "impermissibly punitive" would conflict with other portions of the Exchange Act which expressly authorize them.

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### IV. Implications

In *Saad v. SEC*, the D.C. Circuit upheld the permanent industry bar authorized by FINRA and confirmed by the SEC under the Exchange Act. The court held that *Kokesh*'s reasoning for distinguishing between punitive and remedial sanctions does not apply across legal contexts and is restricted to the statute that *Kokesh* specifically

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<sup>4</sup> In the Matter of the Application of John M.E. Saad for Review of Disciplinary Action Taken by FINRA, Release No. 70632 (Oct. 8, 2013) (SEC order remanding case to FINRA for review of mitigating factors); In the Matter of the Application of John M.E. Saad for Review of Disciplinary Action Taken by FINRA, Release No. 76118 (Oct. 8, 2015) (SEC order sustaining FINRA's determination that industry bar remains).

<sup>5</sup> See also Supreme Court Holds That SEC Disgorgement Is a Form of Equitable Relief (July 27, 2020), available at <https://www.cahill.com/publications/firm-memoranda/2020-07-27-supreme-court-holds-that-sec-disgorgement-is-a-form-of-equitable-relief>.

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addressed, §2462. The D.C. Circuit, therefore, joins several other Courts of Appeal that have refused to apply *Kokesh* beyond §2462.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email Brad Bondi at 202.862.8910 or [bbondi@cahill.com](mailto:bbondi@cahill.com); Joel Kurtzberg at 212.701.3120 or [jkurtzberg@cahill.com](mailto:jkurtzberg@cahill.com); Adam Mintz at 212.701.3981 or [amintz@cahill.com](mailto:amintz@cahill.com); or Grace McAllister at 212.701.3343 or [gmcallister@cahill.com](mailto:gmcallister@cahill.com); or email [publications@cahill.com](mailto:publications@cahill.com).

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