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Recent Rulings Can Help Securities Defendants Avoid Industry Bans

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Recent federal court decisions are creating opportunities for defendants in securities cases to negotiate settlements that do not include being barred from the industry, even when they acted with knowledge of wrongdoing, say Willkie Farr attorneys.

Federal district courts increasingly are expressing concerns about the effect being barred from the securities industry as part of a settlement will have on defendants' livelihoods, even in cases where they acted with knowledge of wrongdoing.

In three recent litigated Securities and Exchange Commission enforcement actions involving violations of the [Investment Advisers Act](#), courts have denied the SEC's request for an injunction that would provide a jurisdictional basis for an administrative proceeding seeking a bar from future work in the securities industry. Meanwhile, constitutional challenges have constrained the SEC's use of contested administrative proceedings where the SEC could seek a bar directly. But the SEC appears routinely to require bars in settled actions involving scienter-based violations of the Act. There is tension between the SEC's regular imposition of bars in a settled context and the SEC's narrowing ability to obtain those bars through litigation.

Highlighting this tension when negotiating settlements with the SEC staff may provide individuals settling Act charges an opportunity to negotiate settlements that do not impose an industry bar.

Advisers Act Settlements

Since 2018, the SEC has settled dozens of enforcement actions involving scienter-based Advisers Act charges against individuals, the vast majority of which include some form of a bar from future work in the securities industry. For the SEC, bars are intended to protect the public by preventing future violations of the securities laws.

From an enforcement action respondent's perspective, bars are often seen as a career-ending sanction. Avoiding a bar is usually one of the respondent's primary objectives in settling a SEC enforcement action. If, however, the commission's insistence on an industry bar impedes the parties' ability to settle, the commission's ability to obtain a bar in litigation is increasingly limited.

Administrative Proceedings

Historically, the SEC addressed alleged individual misconduct by investment advisers through SEC administrative proceedings. If the SEC prevailed in those proceedings, it could seek a bar in the same proceeding.

But, starting at least with the US Supreme Court's 2018 decision in [Lucia v. SEC](#) and continuing through the Fifth Circuit's opinion this May in [Jarkesy v. SEC](#), courts have held that the SEC's use of administrative proceedings suffered from various constitutional infirmities, and have consequently constrained the SEC's use of those proceedings. The practical effect is that the SEC infrequently files contested actions as administrative proceedings and instead files in federal district court.

District Courts' Skepticism

The SEC's reduced use of in-house administrative proceedings has led to more cases being filed in federal district court, including cases involving scienter-based allegations against investment advisers. But, in three recent cases—[SEC v. Westport Capital Markets](#), [SEC v. Ambassador Advisors LLC](#), and [SEC v. McDermott](#)—the SEC did not obtain the relief that it typically demands when seeking settlements in similar cases.

In each of the cases, the SEC charged an investment adviser and other individuals with violations of the Advisers Act arising from allegedly conflicted investment selection decisions. The SEC prevailed in jury trials in all three cases, and in each case the court found that the individual defendants acted with scienter.

At the remedies phase, all three courts did not enter the SEC's requested injunction. In each case, the court applied a multi-factor test in determining whether to enter an injunction and, in each case, the court expressly considered collateral consequences of an industry bar in declining to impose the injunction.

In *Westport*, for example, the court noted that an injunction's impact would be prohibitively severe because it would lead to administrative sanctions that would likely end the defendant's career. The courts in *Ambassador Advisors* and *McDermott* applied the same analysis and similarly declined to impose an injunction partly out of concern that it would be a basis for an administrative proceeding seeking an industry bar.

Defendants Benefit

The SEC's difficulty in obtaining a federal court injunction, even when a court finds scienter, and the limitations on SEC administrative proceedings create opportunities when negotiating settlements with the SEC.

Potential defendants may seek to leverage federal courts' apparent skepticism of industry bars and the practical unavailability of another forum to advocate for a settlement structure that does not include a bar.

Moreover, even if settlement negotiations fail, investment adviser litigants may proceed with some hope that the litigation outcome even if they are found liable may not include an industry bar.

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