BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C.

In the Matter of the Application of

William Joseph Kielczewski

For Review of Disciplinary Action

Taken by

FINRA

File No. 3-20636

SUPPLEMENTAL BRIEF OF WILLIAM J. KIELCZEWSKI IN SUPPORT OF HIS APPEAL OF FINRA'S DISCIPLINARY ACTION

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This application is motivated by a simple proposition: a FINRA ALJ cannot exercise more power with less supervision in enforcing the federal securities laws than an SEC ALJ.

FINRA acts as a *de facto* federal government enforcement agency and exercises executive authority in enforcing the securities laws. FINRA's power is derived from federal statutes, which require that persons and entities in the securities industry become members. FINRA imposes punishment on individuals that carry the force of federal law. FINRA receives immunity for its own conduct that is reserved for governmental actors. FINRA drafts its own rules and enforces them with penalties up to and including a lifetime bar from the industry.

In short, FINRA, through its disciplinary arm, investigates, prosecutes, renders judgment, and punishes violations of federal laws and federally-approved rules, thereby engaging in government action. Yet FINRA insists that it is private and not subject to any constitutional constraints. This effects one of two results. The first is that FINRA takes governmental action, depriving individuals of property and livelihood, without the protections afforded by the Constitution. The second is that FINRA, a private actor, is being delegated executive authority. Neither is permitted by the Constitution.

Lucia v. SEC, 138 S. Ct. 2044 (2018), which doomed the SEC's use of administrative law judges ("ALJs") in enforcement proceedings, also dooms FINRA's adjudicatory structure. It would be inconsistent with the constitutional protections afforded individuals for a private agency's hearing officer to have more freedom from executive review than a comparable SEC ALJ in enforcing the law. *See Alpine Sec. Corp. v. FINRA*, No. 23-5129, 2023 WL 4703307, at *3 (D.C. Cir. July 5, 2023) ("if the ALJs in *Lucia* exercised 'significant' executive power, then FINRA hearing officers probably do too.") (Walker, J., concurring). Whether that requires treating FINRA as the *de facto* federal agency it is and requiring it to provide the necessary constitutional

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protections for individuals like Kielczewski, or whether it means removing the disciplinary powers that its hearing officers wield as "near carbon copies" of the Commission-appointed administrative law judges ("ALJs"), *Alpine* at *2 (Walker, J., concurring), under the non-delegation doctrine is a question for the Commission and ultimately for the courts. But the current *status quo* cannot survive. The Commission should vacate the decision by FINRA against Kielczewski.

LEGAL ISSUES SUBMITTED TO THE COMMISSION

The Commission has permitted Kielczewski to submit this supplemental briefing addressing four issues: (1) whether the process used to appoint FINRA hearing officers violates the U.S. Constitution's Appointments Clause; (2) whether the process required to remove FINRA hearing officers violates the Constitution's separation of power guarantees; (3) whether the Constitution's due process and jury trial requirements apply to this proceeding; and (4) whether, because FINRA's disciplinary scheme relies on an unconstitutional structure, this proceeding should be vacated or, at a minimum, stayed pending resolution in *Alpine Securities Corp. v. FINRA*, No. 23-5129 (D.C. Cir. 2023) ("*Alpine"*). *Alpine* is pending review of a motion for a preliminary injunction before the U.S. Court of Appeals for the District of Columbia. SEC Release No. 98435.[1]

The first three issues rest on the determination of whether FINRA exercises executive power when it enforces the federal securities laws. If so, FINRA's present structure and exercise of power violates the Appointments Clause, the separation of powers guarantees, due process, and the right to a jury trial, and the disciplinary action against Kielczewski should be vacated due to these constitutional defects. In the alternative, if FINRA is a private actor, it is exercising non-

[1] The briefing schedule for the appeal in *Alpine* calls for the final submission to be made on November 17, 2023. As of the time of this submission no date has been set for oral argument.

delegable executive powers in violation of the Constitution and, again, the action should be vacated.

Finally, the Commission should reject FINRA's argument that Kielczewski was required to exhaust his claims before FINRA before raising them here. Under its own rules, the Commission can consider issues on the merits notwithstanding a failure to exhaust administrative remedies. Recent Supreme Court precedent weighs against requiring exhaustion. Finally, given the fundamental importance of these issues to the enforcement of the securities laws, the Commission should state its views for the benefit of FINRA's current members and the courts considering this issue.

Alternatively, Kielczewski requests the Commission stay these proceedings pending the decision in *Alpine*.

FACTUAL BACKGROUND

Kielczewski was a registered representative required by federal law to register with FINRA. FINRA brought charges against him, alleging that Kielczewski had engaged in undisclosed private securities transactions by virtue of his interest in a hedge fund that invested in private label mortgage-backed securities. Prior to the events giving rise to this action, he had worked in the industry for 18 years without a blemish on his record.

Nine days before FINRA's hearing into the matter was scheduled to begin, it was discovered that his former employer, to whom the relevant disclosures were made, had withheld documents from its own internal investigation in responding to FINRA's Rule 8210 requests. Kielczewski sought production of the documents; however, in violation of FINRA's own rules, the hearing officer presiding over the matter required the hearing to proceed on a materially incomplete and, therefore, inaccurate record. Kielczewski's former employer never provided, or

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even identified, the wrongfully withheld documents. Because this case depended in large part on an alleged failure by Kielczewski to disclose, *in writing*, his involvement in certain securities transactions, even a single document could have changed the outcome of the proceedings. Kielczewski was ultimately sanctioned with an 18-month suspension and a significant monetary penalty.[2]

I. FINRA's enforcement arm engages in government action.

FINRA is the sole national securities association in the United States. Nearly every individual conducting securities transactions and business with the investing public must register with FINRA. *See* FINRA Registration https://www.finra.org/registration-exams-ce/registration. FINRA describes its purpose as the "vigorous, fair and effective enforcement of FINRA and MSRB rules, and federal securities laws and rules." "FINRA Enforcement: Who We Are." https://www.finra.org/rules-guidance/enforcement. It notes that it "charged [a] broker with securities fraud" as an example of its purpose and power. "FINRA: What We Do." https://www.finra.org/about/what-we-do.

It is beyond reasonable dispute that FINRA performs adjudicatory, regulatory, and prosecutorial functions, including implementing and effectuating compliance with the securities laws. *See Weissman v. NASD*, 500 F.3d 1293, 1296 (11th Cir. 2007) (describing the function and authority of one of FINRA's predecessors). FINRA "serves as a quasi-governmental agency, with express statutory authority to adjudicate actions against members who are accused of illegal securities practices and to sanction members found to have violated the Exchange Act or Securities and Exchange Commission [] regulations[.]" *NASD v. SEC*, 431 F.3d 803, 804-06 (D.C. Cir. 2005)

[2] A complete description of the facts underlying the charges against Kielczewski and the proceedings brought by FINRA is provided in Kielczewski's principal brief at 2-12.

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(discussing FINRA predecessor NASD). When a FINRA member violates the Exchange Act, FINRA is empowered to "levy sanctions that carry the force of federal law." *Turbeville v. FINRA*, 874 F.3d 1268, 1270–71 (11th Cir. 2017).

"[T]he enforcement of federal law" is a core presidential power. *Nixon v. Fitzgerald*, 457 U.S. 731, 750 (1982). "[I]t is the President who is charged constitutionally to take Care that the Laws be faithfully executed." *Id.* (internal quotation marks omitted). The enforcement of federal laws and the appointment of agents with the duty of carrying out such enforcement are exclusively executive functions. *See United States v. Texas,* 143 S. Ct. 1964, 1971 (2023). The law does not allow the government to subvert the Constitution by delegating that authority to private actors and then exempting them from the structural protections of the Constitution. *See Ass'n of Am. R.R. v. U.S. Dep't of Transp*., 721 F.3d 666, 670 (D.C. Cir. 2013), *vacated and remanded on other grounds*, *U.S. Dep't of Transp. v. Ass'n of Am. R.R*., 575 U.S. 43 (2015). Rather, such powers must be exercised solely by the President and persons appointed by the President. "The entire 'executive Power' belongs to the President alone . . . [and] [t]hese lesser officers [appointed to assist in carrying out that power] must remain accountable to the President, whose authority they wield." *Seila Law LLC v. Consumer Fin. Prot. Bureau*, 140 S. Ct. 2183, 2197 (2020).

A private party engages in government action when it "acts as an agent of the government in relevant respects," *NB ex rel. Peacock v. D.C*., 794 F.3d 31, 43 (D.C. Cir. 2015), when "a nominally private entity . . . is entwined with governmental policies," *Brentwood Acad. v. Tennessee Secondary Sch. Athletic Ass'n*, 531 U.S. 288, 288-89 (2001), or when the government has "so far insinuated itself into a position of interdependence with" a "private" entity "that it [is] a joint participant in the enterprise," *Jackson v. Metro. Edison Co*., 419 U.S. 345, 357–58 (1974). State action also exists "when the government compels the private entity to take a particular

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action." *Manhattan Cmty. Access Corp. v. Halleck*, 139 S. Ct. 1921, 1928 (2019). In *Blount v. SEC,* 61 F.3d 938 (D.C. Cir. 1995), the Court of Appeals for the D.C. Circuit found that the Municipal Securities Rulemaking Board engaged in state action where it was the gatekeeper to participation in the industry and had the authority to issue rules for the industry which members could be expelled for violating.

FINRA falls squarely within this standard. FINRA is empowered to enforce federal law as well as to create and enforce its own rules that, once approved by the SEC, carry the force of federal law. *Birkelbach v. SEC*, 751 F.3d 472, 475 n.2 (7th Cir. 2014) ("The SEC must approve FINRA's rules which, once adopted by the SEC, have the force of law"); *Domestic Secs., Inc. v. SEC*, 333 F.3d 239, 242 (D.C. Cir. 2003). FINRA has the authority to discipline, and expel, participants in the industry for violations of the securities laws and for violations of its own rules. *See NASD*, 431 F.3d at 804, 811 (FINRA "has been delegated governmental power" and "[t]he authority [FINRA] exercises in this realm . . . ultimately belongs to the SEC") (internal citation and quotation marks omitted). FINRA holds itself out as engaging in "vigorous. . . enforcement of FINRA and MSRB rules, and federal securities laws and rules." "FINRA Enforcement: Who We Are." https://www.finra.org/rules-guidance/enforcement. FINRA can "levy sanctions that carry the force of federal law." *Turbeville,* 874 F.3d at 1270; *see* 15 U.S.C. § 78o-3(b)(6). The power to sanction and prohibit persons from working in an industry is a classic form of executive power. *See Texas*, 143 S. Ct. at 1971 ("the Executive Branch has exclusive authority and absolute discretion to decide whether to prosecute a case") (internal citation and quotation marks omitted).

The immunity which has been granted to FINRA further demonstrates that it is engaged in government action in its disciplinary activities. In *Weissman*, 500 F.3d at 1296, the court held that "[b]ecause they perform a variety of vital governmental functions . . . SROs [Self-Regulating

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Organizations] are protected by absolute immunity when they perform their statutorily delegated adjudicatory, regulatory, and prosecutorial functions." This immunity has been upheld by a number of courts. *See, e.g., Standard Inv. Chartered, Inc. v. NASD*, 637 F.3d 112, 115 (2d Cir. 2011); *Gallagher v. FINRA*, No. 21-13605, 2022 WL 1815594, at *2 (11th Cir. June 3, 2022), *cert. denied*, 143 S. Ct. 373 (2022); *Hurry v. FINRA*, 782 Fed. App'x 600, 602 (9th Cir. 2019). The Constitution does not support a paradox by which FINRA is a government actor for the purpose of having immunity but is not a government actor when it tramples the constitutional rights of others. *See U.S. Dep't of Transp. v. Ass'n of Am. R.R.*, 575 U.S. 43, 57 (2015) (Alito, J. concurring) ("Liberty requires accountability").

Applying these fundamental principles of constitutional law, the conclusion that inexorably follows is that FINRA is engaging in government action when it exercises its adjudicatory and enforcement powers and is, therefore, subject to constitutional restraints. *See Blount*, 61 F.3d at 941. Of course, in the alternative, as argued below, FINRA is a private entity impermissibly using governmental power to inflict penalties on persons while largely free of government oversight.

II. FINRA's dominance of the securities industry fatally undermines any argument that it is a private, voluntary association that merely aids or assists the SEC.

FINRA has argued, often successfully, that is a "private" actor and therefore not required to comply with the constitutional protections against government action provided by the Constitution, including the Appointments and Removal Clauses, Due Process under the Fifth and Fourteenth Amendments, and the right to a jury trial under the Seventh Amendment. Under the private non-delegation doctrine, which arises from Article II of the Constitution, a private actor may not wield executive power and can act only as an aid subject to the close supervision and control of a properly accountable government agency. *See Ass'n of Am. R.R.*, 721 F.3d at 670-71 ("Federal lawmakers cannot delegate regulatory authority to a private entity" and "Congress may

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formalize the role of private parties in proposing regulations so long as that role is merely 'as an aid' to a government agency") (internal citation omitted); *see also Ass'n of Am. R.R. v. U.S. Dep't of Transp.,* 821 F.3d 19, 37 (D.C. Cir. 2016).

Private entities may serve in "*ministerial* or *advisory* roles," but Congress and agencies "may not give these entities governmental power over others." *Pittston Co. v. United States*, 368 F.3d 385, 395 (4th Cir. 2004); *see Ass'n of Am. R.R.*, 721 F.3d at 671 n.5. A private entity "may not be the principal decisionmaker in the use of federal power." *Oklahoma v. United States*, 62 F.4th 221, 229 (6th Cir. 2023). The reasons for this are accountability and restraint. "Those who exercise the power of Government are set apart from ordinary citizens. Because they exercise greater power, they are subject to special restraints." *U.S. Dep't of Transp.*, 575 U.S. at 58 (Alito, J., concurring).

FINRA exercises executive power over others and is not subject to close supervision or control. For example, neither the Commission nor any other part of the executive branch can control FINRA's investigations, its hearing officer's obedience to FINRA's procedural rules, its decisions to initiate enforcement proceedings, or stop prosecutions. The SEC cannot appoint FINRA's hearing officers or remove them. If not constrained by the Constitution regarding such government action, FINRA's enforcement arm would have unconstitutionally broad discretion over participation in the securities industry and individual citizen's livelihoods, and FINRA's current structure and powers would violate Article II. While the Commission can, and does, take appeals from final rulings of the NAC in disciplinary matters, that review comes only after years of investigation, preparation for a FINRA hearing, the hearing itself, and a NAC appeal from the results of that hearing. This is of paramount importance for persons like Kielczewski, during a period when such persons are largely unemployable in the securities industry due to the adverse

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reports regarding the FINRA investigation and/or disciplinary outcomes on their FINRA-required Form U4 and Form U5 disclosures. Practically speaking, for most matters, most of the time, FINRA is the regulatory authority; it is no mere "advisor" or "aid" to the Commission in the enforcement of securities laws in the United States. Tellingly, the review of decisions by the SEC's own ALJs by the Commission was insufficient to save the constitutionality of ALJs exercising executive power who are not appointed consistent with the Appointments Clause. *See Lucia*, 138 S. Ct. at 2054. The Commission's review of final decisions by FINRA ALJs (or the NAC for that matter) cannot save them.

FINRA has relied on the history of its predecessor entities to support its arguments that it is a "private" organization with limited powers that acts in an advisory capacity to the SEC,[3] but the historical precedent of its predecessor SROs does not save FINRA. The FINRA of today is dramatically and substantively different than traditional SROs. Modern-day "FINRA is not a self-regulator. Its members are not regulating themselves; they are being regulated by FINRA, just as they are regulated by the SEC." Hester Peirce, The Financial Industry Regulatory Authority: Not Self-Regulation After All, at 27, GEO. MASON UNIV. (Mercatus Ctr., Working Paper 2015), available at https://bit.ly/3KWlETa. FINRA bears almost no resemblance to the SROs of the New Deal era, much less the voluntary associations of stockbrokers of the eighteenth and nineteenth

[3] *See, e.g.*, FINRA Motion to Vacate TRO in *Alpine Securities v. FINRA*, No. 23-5129, Document Number 2008678 (arguing that FINRA was in the class of permissible "aides and advisors" to the SEC) (quoting *Oklahoma*, 62 F.4th at 229). However, these statements are not binding precedent, and further rely on precedent that predates the significant expansion of FINRA's regulatory authority: the statutory authorization to SROs to enforce federal securities laws in 1975, the statutory requirement that natural persons become affiliated with SROs to work in the securities industry in 1993, and the merger of NASD and NYSE in 2007, leaving only a single national securities association in the US securities industry.

centuries. *See generally* Birdthistle & Henderson, Becoming a Fifth Branch, 99 CORNELL L. REV. 1, 12–24 (2013).

FINRA's encroachment on the powers of the Commission has increased greatly over time. In 1975, Congress empowered SROs to enforce federal securities laws. *See* Securities Act Amendment of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975) At that time Congress granted the rules of self-regulatory organizations the power of federal law, subject to review and revision by the Commission. *See Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1130-32 (9th Cir 2005). In 1983, Congress made membership in FINRA's predecessor mandatory for most broker-dealers. *See* "An Act to make certain amendments to sections 4, 13, 14, 15, and 15 B of the Sec. and Exch. Act of 1934," Pub. L. No. 98-38, § 3(a), 97 Stat. 205 (June 6, 1983). The Commission required natural persons to become members of FINRA predecessors in 1993. *See Duffield v. Robertson Stephens & Co.,* 144 F.3d 1182, 1200 (9th Cir. 1998), *overruled on other grounds by EEOC v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742 (9th Cir. 2003). In 1996, dissatisfied with a "lack of vigor and balance in . . . enforcement activities" by the NASD, FINRA's predecessor, the SEC responded by ordering the NASD to change its leadership structure to insulate enforcement decisions from member influence. *See* "Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the Nasdaq Market," Exch. Act Release No. 37,542, at 39, SEC (Aug. 8, 1996), https://bit.ly/3NFzPgY; *see also In re NASD*, SEC Release No. 37538, 1996 WL 447193 (Aug. 8, 1996). When the NASD merged with the New York Stock Exchange's enforcement arm to form FINRA in 2007, the SEC conditioned its approval on additional changes to the leadership structure that further eroded member influence. *See* Birdthistle & Henderson, *supra*, at 23. As previously noted, when the SEC approved the merger, only one

registered national securities agency remained in the United States.[4] Because of previous rule changes that required both broker-dealers and natural persons to be registered with an SRO to work in the securities industry, FINRA's orders of suspension or expulsion carry the same consequences as SEC orders to the same effect.

This shift in FINRA's relationship with the government has "effectively entwined the SEC and its SROs, making it difficult to characterize the SEC's role as purely oversight." Benjamin P. Edwards, Supreme Risk, 74 FLA. L. REV. 543, 559 (2022); *see also, e.g.*, Birdthistle & Henderson, *supra*; Stone & Perino, Not Just a Private Club: Self-Regulatory Organizations as State Actors When Enforcing Federal Law, 2 COLUM. BUS. L. REV. 453 (1995), available at https://bit.ly/3YPdqC6. As SEC Commissioner Hester Peirce put it: "on the strength of a government mandate and carrying out a regulatory mission using government-like tools, FINRA is difficult to distinguish from its patron agency." Hester Peirce, The Financial Industry Regulatory Authority: Not Self-Regulation After All, at 20, GEO. MASON UNIV (Mercatus Ctr., Working Paper 2015). Former SEC Commissioner Daniel M. Gallagher expressed similar concerns regarding the lack of member influence over FINRA: "This decrease in the 'self' aspect of FINRA's self-regulatory function has been accompanied by an exponential increase in its regulatory output. As FINRA acts more and more like a 'deputy' SEC, concerns about its accountability grow more pronounced." (quoted in David Burton, Reforming FINRA,

[4] https://www.sec.gov/rules/sro. One other SRO with supervisory powers comparable to FINRA's continues to exist in the United States, the Municipal Securities Rulemaking Board (MSRB). But as its name would suggest, it has a narrow focus and is no sense a competitor with or rival to FINRA. It also should be noted that the status of MSRB as a purely private agency has been questioned. *See Blount,* 61 F.3d at 941 (noting in passing that "[w]e put to one side the Board's questionable assertion that it is a purely private organization").

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Backgrounder No. 3181 at note 55; *see* Emily Hammond, Double Deference in Administrative Law, 116 COLUM. L. REV. 1705, 1771 (Nov. 2016)).

For these reasons, history provides little support for FINRA's current structure and exercise of federal power. In fact, history demonstrates that FINRA's modern expansion—an unprecedented exercise of federal power by a nominally private party against other private parties and an unprecedented development in the regulation of the securities industry—is so novel as to raise constitutional scrutiny on that basis alone.

One case FINRA has principally relied upon, *Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999), addresses the enforcement of an arbitration agreement, but the enforcement powers of FINRA not at all. The other Court of Appeals case that FINRA has relied upon, *Duffield*, provides even less support because it was explicitly decided on the basis that the SEC only required broker-dealers to register with an SRO in 1993, years after the plaintiff had signed the arbitration agreement: "No federal law required Duffield to waive her right to litigate employment-related disputes by signing the Form U–4 in 1988." 144 F.3d at 1201.

Prosecutorial functions are at the heart of government power. FINRA is not running a railroad, operating a hospital, or providing community access to a channel on cable television. The Supreme Court has ruled that a variety of functions do not fall into the category of a government function, such as: running sports associations and leagues, administering insurance payments, operating nursing homes, providing special education, representing indigent criminal defendants, resolving private disputes, and supplying electricity. *See Manhattan Cmty. Access Corp.*, 139 S. Ct. at 1929 (citing cases on non-core governmental functions). But the prosecution and sanctioning of individuals and businesses, to the extent even of imposing lifetime bars, fines, or expulsion, surely does fall within the functions belonging to the government.

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III. FINRA's current structure and exercise of power violates the Constitution.

Because FINRA is effectively a federal agency carrying out a core executive function of enforcing the laws, it must do so consistent with the requirements of the Constitution.

FINRA's structure and procedures do not comply with constitutional requirements in at least three areas. First, as the D.C. Circuit has already found, on a preliminary basis, FINRA's ALJs are not appointed by the President or one of the President's inferior officers, and so serve in violation of the Appointments Clause. Second, FINRA's ALJs cannot be removed by the President or one of the President's inferior officers, and so serve in violation of the Removal Clause. Third, FINRA's adjudicatory procedures violate the Seventh Amendment and due process protections.

1. The Appointments Clause. The Appointments Clause, U.S. Const. art. II, § 2, cl. 2, applies to officers of the United States and those who exercise "significant authority pursuant to the laws of the United States." *Free Enter. Fund v. v Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 486 (2010) (internal citation and quotation marks omitted). In *Lucia*, 138 S. Ct. at 2053–55, the Supreme Court held that SEC ALJs are officers of the United States and must be appointed in accordance with the Appointments Clause. The Court reasoned that SEC ALJs exercise "significant discretion," have "the authority needed to ensure fair and orderly adversarial hearings," and may serve as the "last-word." *Id.* at 2053–54. All of that is also true of the FINRA hearing officers who conducted the proceedings for Kielczewski. Accordingly, the reasoning in *Lucia* applies. FINRA's hearing officers have significant discretion, the authority to ensure fair and orderly adversarial hearings, and may serve as the last word in such proceedings. *See* FINRA Rule 9235; FINRA Rule 8210; FINRA Rule 9252; FINRA Rule 9280. This is not a mere technicality. The FINRA hearing officers have significant power and their proper appointment is

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fundamental to fair proceedings. Here, it was a single hearing officer who decided to set aside the rules of procedure in Kielczewski's hearing and proceed on an incomplete record.

If the Commission finds that FINRA engages in government action in its enforcement and adjudicatory proceedings, it is beyond reasonable dispute that the appointment of FINRA hearing officers violates the Appointments Clause. Hearing officers are appointed and overseen by FINRA's chief executive officer.[5] Neither FINRA's chief executive officer nor any member of FINRA's Board of Governors (which is responsible for appointing that chief executive officer) is appointed by the President or the Commission. For that matter, the two Panelists who also presided over Kielczewski's disciplinary hearing were not appointed by the President or one of the President's inferior officers. The same is true of the members of the NAC who considered and almost entirely rejected Kielczewski's arguments on appeal.

It has long been recognized that "[FINRA] serves as a quasi-governmental agency, with express statutory authority to adjudicate actions against members who are accused of illegal securities practices and to sanction members found to have violated the Exchange Act or Securities and Exchange Commission … regulations issued pursuant thereto." *NASD*, 431 F.3d at 804 (addressing the NASD). "As a registered securities association, [FINRA] has been delegated governmental power to enforce the legal requirements laid down in the Exchange Act." *Id.* (cleaned up) (citation omitted). Given the ruling in *Lucia*, it is impossible to justify the continued exercise of such power outside the effective supervision by the executive. As Judge Walker held in his concurring opinion in *Alpine*, "[i]t would be odd if the Constitution prohibits Congress from vesting significant executive power in an unappointed and unremovable government administrator

[5] *See* https://www.finra.org/rules-guidance/adjudication-decisions/office-hearing-officers-oho/about.

but allows Congress to vest such power in an unappointed and unremovable private hearing officer." 2023 WL 4703307, at *3.[6]

Because the FINRA Hearing Officers wield as much, if not more,[7] power in the enforcement of the securities laws than their colleagues who serve as ALJs for the Commission, they must be appointed consistent with the Appointments Clause. They are not. Relief is accordingly required.

2. The President's removal powers. Article II, §§ 1, 3 of the Constitution vests in the President the executive power to execute the laws of the nation. *Seila Law LLC*, 140 S. Ct. at 2191 (quoting U.S. Const. art. II, §§ 1, 3). The President is assisted by executive officers to carry out this duty; however, the Constitution requires that the President have the power to remove the executive officers and that the executive officers, in turn, have the power to remove the inferior officers who serve under them. *See id*. In *Free Enter. Fund,* the Supreme Court held that the structure of the Public Company Accounting Oversight Board ("PCAOB"), a private quasi-governmental board, violated the separation of powers because its officers enjoyed two separate levels of protection from presidential removal. The board's members could not be removed at will by the principal officer overseeing them, and that principal officer in turn could also not be removed at will by the President. 561 U.S. at 482. FINRA's structure is for all relevant purposes

[6] As the Supreme Court held in *Lucia*, the review of ALJ decisions by the Commission is insufficient to save the constitutionality of ALJs exercising executive power who are not appointed consistent with the Appointments Clause. *Lucia*, 138 S. Ct. at 2054-55.

[7] FINRA hearing officers have the power to impose discipline for violation of FINRA's own rules, including the famously vague and expansive FINRA Rule 2010, which provides that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade[,]" in addition to the federal securities laws.

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identical to the PCAOB. The President does not have the authority to remove FINRA board members, executives, or its hearing officers, nor does the Commission.

3. Due process and the right to a jury trial. FINRA's procedural rules fall short of Due Process. The rules of evidence do not apply; hearsay is customarily accepted; the defendant in a disciplinary proceeding has extraordinarily limited rights to discovery; there is no jury; and FINRA acts as investigator, prosecutor, and judge. Nothing in FINRA's rules limits the admissibility of evidence that is unreliable or not authenticated. FINRA Rule 9263 (Evidence: Admissibility). Moreover, FINRA Rule 2010, under which Kielczewski was sanctioned, broadly states that "in the conduct of its business, [regulated persons] shall observe high standards of commercial honor and just and equitable principles of trade." This rule is too vague to give adequate notice of prohibited conduct. *See Karem v. Trump*, 404 F. Supp. 3d 203, 209 (D.D.C. 2019), *aff'd as modified*, 960 F.3d 656 (D.C. Cir. 2020) (due process requires the law or rule to "provide a person of ordinary intelligence fair notice of what is prohibited") (internal citation and quotation marks omitted). For the reasons described above, FINRA's enforcement of the federal securities law is so intertwined with a government function that Due Process should apply. Because the FINRA proceedings did not comport with Due Process, the result should be vacated. *See NB ex rel. Peacock*, 794 F.3d at 43 ("The requisite nexus generally exists when a private party acts as an agent of the government in relevant respects").

Kielczewski is entitled to a trial by jury. The Seventh Amendment guarantees all defendants the right to a jury trial on the merits in those actions that "are analogous to '[s]uits at common law[,]'" like civil enforcement actions. *See Tull v. United States*, 481 U.S. 412, 417 (1987) (internal citation omitted). The conduct Kielczewski is accused of but did not commit is, at base, fraud—failing to disclose material information to his employer so he could personally

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benefit. The punishment sought by FINRA was to deprive Kielczewski of his livelihood and to charge him significant monetary penalties. A fraud action seeking monetary penalties is a legal claim at common law. *See id.* at 414-19. Even where the proceeding is a mix of legal and equitable claims, such as here where both a ban and monetary penalties were sought by FINRA, the Supreme Court has held that the Seventh Amendment right to a jury trial still applies because the facts relevant to the legal claims must be adjudicated by a jury, even if those facts also relate to the equitable claim. *See Ross v. Bernhard*, 396 U.S. 531, 537-38 (1970).

The right that FINRA, acting with government power, was seeking to vindicate is a private right, that of Mr. Kielczewski's former employer, the purported victim of the alleged fraud, so the exception to the jury trial right created by the public-rights doctrine does not apply.[8] *See Thomas v. Union Carbide Agr. Products Co.*, 473 U.S. 568, 586 (1985) (whether a claim involves a public or private right rests on the nature of the claim, not the identity of the plaintiff or its incorporation into a statutory scheme). The Fifth Circuit has recently ruled that the SEC's in-house proceedings are unconstitutional for such claims, in part, because the accused has the right to a jury trial. *Jarkesy v. SEC*, 34 F. 4th 446, 451 (5th Cir. 2022) ("The Seventh Amendment guarantees Petitioners a jury trial because the SEC's enforcement action is akin to traditional actions at law to which the jury-trial right attaches"). That decision is under review by the Supreme Court. *SEC v. Jarkesy*, 143 S. Ct. 2688 (2023) (granting writ of certiorari). FINRA's proceeding against Kielczewski was constitutionally infirm for the same reasons and should be vacated.

[8] Among other things, the Hearing Panel found, and the NAC confirmed, that Kielczewski had willfully deceived his employer in disclosures on Form U4 and otherwise. FINRA 005347-5349 (Hearing Panel Decision); FINRA 005586-5591 (NAC Decision).

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IV. Because of the constitutional defects, the Commission should vacate FINRA's action against Kielczewski.

A judgment issued by a hearing officer sitting in violation of the Constitution's structural requirements or the non-delegation clause should be vacated. That was the remedy the Supreme Court prescribed in *Lucia* and it should be applied here. 138 S. Ct. at 2055. *See also Ryder v. United States*, 515 U.S. 177, 182-83 (1995) (reversing court martial where military judges sat in violation of Appointments Clause, eschewing harmful error analysis). Alternatively, because the decision by the Court of Appeals for the District of Columbia in *Alpine* will inform the Commission's understanding of FINRA as a government or private actor, and the extent to which FINRA's action constitutes "government action" subject to constitutional restraints, this matter should be stayed pending resolution in that case. *See Lockyer v. Mirant Corp*., 398 F.3d 1098, 1109 (9th Cir. 2005) (citing *Landis v. N. Am. Co*., 299 U.S. 248, 254 (1936)). In *Landis*, two companies sued the SEC to enjoin the enforcement of the Public Utilities Holding Act on constitutional grounds. A number of suits raising the same or similar claims were brought by other parties and the Supreme Court held that a short reasonable stay may be appropriate to simplify issues of law. *Id.* at 254-55. *Alpine* is scheduled to be fully briefed on November 17, 2023, with a decision on the merits of the preliminary injunction Alpine has sought likely to come reasonably soon thereafter. The stay requested here would, therefore, likely be relatively short.

V. Kielczewski does not need to exhaust these claims before raising them before the Commission.

The Commission may consider the merits of any issue regardless of exhaustion. In *In re Newport Coast Sec., Inc.*, Exchange Act Release No. 88548, 2020 WL 1659292 (Apr. 3, 2020), the Commission determined it had the discretion to consider a constitutional challenge to the Appointments Clause not raised before FINRA, one of the constitutional issues Kielczewski raises

here. *Id.* at *17. The Commission, however, declined to exercise its discretion to consider those arguments, citing administrative and judicial decisions favoring administrative exhaustion.

However, subsequent decisions by the Supreme Court in *Carr v. Saul*, 141 S. Ct. 1352, 1362 (2021) and *Axon Enter., Inc. v. FTC*, 598 U.S. 175 (2023), weigh in favor of considering the merits of the kinds of constitutional arguments that Kielczewski seeks to raise in this appeal, as does the recent decision of the D.C. Court of Appeals in *Alpine*.

In *Carr*, the Supreme Court noted that "[a]dministrative review schemes commonly require parties to give the agency an opportunity to address an issue before seeking judicial review of that question . . . (known as issue exhaustion)," *id.* at 1358, but found that a combination of the non-adversarial qualities of the administrative proceedings, together with the usual exceptions to exhaustion, specifically those of structural challenges and futility (described in more detail below) weighed against requiring petitioners to raise their challenges before the agency in order to preserve them for judicial review. *See id.* at 1362.

In *Axon,* the Supreme Court found that administrative review need not precede constitutional challenges to agency action. *Id.* at 195-96. The Supreme Court found that petitioners could skip administrative proceedings altogether in bringing structural constitutional challenges like the ones Kielczewski seeks to raise now: constitutional challenges "charg[ing] that an agency is wielding authority unconstitutionally in all or a broad swath of its work" can be brought directly in district court. *Id.* at 189. These decisions build on a long-standing history of excusing exhaustion in such structural changes to agency action.

Even before *Carr* and *Axon*, courts, including the Supreme Court, have found Appointments Clause challenges to fall within the category of "structural" constitutional challenges that do not require exhaustion for preservation: "Appointments Clause objections to

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judicial officers [fall] in the category of nonjurisdictional structural constitutional objections that could be considered on appeal whether or not they were ruled upon below." *Freytag v. C.I.R.*, 501 U.S. 868, 878–79 (1991).

Structural challenges fall within well-established exceptions to the doctrine of administrative exhaustion: (1) the inadequacy of the regulator's process to determine the issue and (2) futility of raising such claims before an agency that is incapable of granting the requested relief. *See, e.g., Randolph-Sheppard Vendors of Am. v. Weinberger*, 795 F.2d 90, 104 (D.C. Cir. 1986) ("courts have developed exceptions to the exhaustion requirement in circumstances where 'the reasons supporting the doctrine are found inapplicable'") (internal citation omitted). Both exceptions are applicable here. FINRA's hearing officers are simply not suited to assess constitutional challenges to their own authority and further have no ability to remediate the problem. *See Hettinga v. United States*, 560 F.3d 498, 506 (D.C. Cir. 2009) ("it would make little sense to require exhaustion where an agency lacks institutional competence to resolve the particular type of issue presented, such as the constitutionality of a statute or where an agency may be competent to adjudicate the issue presented, but still lacks authority to grant the type of relief requested") (cleaned up, internal citations omitted); *see also Sidak v. U.S. Int'l Trade Comm'n*, No. 23-CV-00325 (TNM), 2023 WL 3275635, at *8, 10-11 (D.D.C. May 5, 2023) (citing *Carr,* 141 S. Ct. at 1362 (rejecting the agency's argument that petitioners' Appointments Clause challenge was untimely because it was not raised during administrative proceedings)); *Jones Bros., Inc. v. Sec'y of Labor*, 898 F.3d 669, 677 (6th Cir. 2018) (excusing forfeiture of Appointments Clause challenge given "absence of legal authority addressing whether the Commission could entertain the claim" at all).

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FINRA's hearing officers (and the NAC's) have no expertise in constitutional issues or Appointments Clause jurisprudence in particular, and there is no reason to defer to their legal conclusions on such subjects. Moreover, any application to the FINRA hearing officer (or the NAC) concerning the Appointments Clause violation would have been futile because FINRA has no power to grant the remedy Kielczewski seeks, *viz.*, the conduct of the proceeding before a properly appointed official. This is because, unlike the SEC, which following the decision in *Lucia,* could appoint ALJs consistent with the requirements of the Appointments Clause, FINRA has no authority to appoint officers that would comply with the Constitution.

CONCLUSION

For the reasons stated above and in his prior briefing, Kielczewski respectfully requests that the Commission vacate the FINRA determination against him and dismiss the action. In the alternative, he requests that the Commission stay its decision pending a merits determination by the Circuit Court for the District of Columbia in *Alpine.*

Dated: October 24, 2023
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/s/

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CERTIFICATE OF COMPLIANCE

I, Andrew St. Laurent, certify that I have complied with the Commission's Rules of Practice by filing a Reply that omits or redacts any sensitive personal information described in Rule of Practice 151(e).

Dated: October 24, 2023

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CERTIFICATE OF SERVICE

I, Andrew St. Laurent, certify that on this 24th day of October 2023, caused a copy of the foregoing Reply to FINRA's Opposition to Request for Supplemental Briefing, In the Matter of the Application of William Joseph Kielczewski, Administrative Proceeding File No. 3-20636, to be served through the SEC's eFAP system on:

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I further certify that, on this date, I caused copy of FINRA's opposition in the foregoing matter to be served by electronic service on:

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