

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 88548 / April 3, 2020

Admin. Proc. File No. 3-18555

In the Matter of the Application of
NEWPORT COAST SECURITIES, INC.
For Review of Disciplinary Action Taken by
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY
PROCEEDING

Former member firm appeals from FINRA disciplinary action finding that it was liable for its registered representatives' excessive trading, churning, and qualitatively unsuitable recommendations, and that it failed to provide reasonable supervision. *Held*, FINRA's findings of violations and imposition of sanctions are *sustained*.

APPEARANCES:

John W. Stenson, Jeanine V. Stepanian, and Alexis T. King, of Winget Spadafora & Schwartzberg, LLP, for Newport Coast Securities, Inc.

Alan Lawhead, Megan Rauch, and Jenifer Brooks for FINRA.

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Newport Coast Securities, Inc., formerly a FINRA member firm, seeks review of FINRA disciplinary action.¹ FINRA found that, between 2008 and 2013, Newport violated the federal securities laws and FINRA and NASD rules based on its registered representatives' excessive trading, churning, and qualitatively unsuitable recommendations, as well as Newport's unreasonable supervision of certain of those registered representatives. FINRA expelled Newport from membership, imposed a \$403,000 fine, and ordered it to pay approximately \$853,000 in restitution and approximately \$41,000 in costs.

Newport does not directly contest its liability or the order to pay a fine and restitution. Instead, Newport argues that FINRA's proceedings were constitutionally and procedurally defective and that FINRA's order of expulsion was excessive and oppressive.² We reject Newport's arguments and sustain FINRA's finding of violations and the sanctions it imposed.

I. Background

Newport, formerly known as Grant Bettingen, Inc., changed its name to Newport in fall 2009. By the end of 2010, Newport employed approximately 120 to 130 registered persons across the United States. Newport's violations implicate the conduct of five of its registered representatives: Douglas Leone, Andre La Barbera, David Levy, Antonio Costanzo, and Donald Bartelt; and two of its registered principals: Marc Arena and Roman Tyler Luckey.

Arena supervised Newport's Long Island branch office in Melville, New York. Leone was assigned to the firm's Long Island office but worked primarily out of his home, first in East Northport, New York, and later in Sandy Hook, Connecticut. Luckey worked in the firm's home office in Irvine, California, but supervised La Barbera, who worked out of his home in New York; Levy, who worked in a branch office in West Palm Beach, Florida; and Costanzo, who worked from his home in Virginia. Bartelt worked in Newport's branch office in Cave Creek, Arizona, and the firm's supervision of him is not at issue in this matter.

¹ *Dep't of Enf't v. Newport Coast Sec., Inc.*, Complaint No. 2012030564701, 2018 WL 2441496 (NAC May 23, 2018).

² Newport writes in its opening brief that its appeal involves FINRA's determination "that Newport is statutorily disqualified pursuant to Section 3(a)(39) of the Securities Exchange Act of 1934." 15 U.S.C. § 78c(a)(39). FINRA, however, made no determination about whether Newport was statutorily disqualified. Newport is instead presumably referring indirectly to the fact that the firm became statutorily disqualified because of FINRA's order of expulsion. *See* 15 U.S.C. § 78c(a)(39)(A) (defining an entity as subject to statutory disqualification if, among other things, it "has been and is expelled or suspended from membership" from an SRO); *see also Michael Earl McCune*, Exchange Act Release No. 77375, 2016 WL 1039460, at *9 (Mar. 15, 2016) (explaining that "FINRA does not subject a person to statutory disqualification as a penalty or remedial sanction" and that, "[i]nstead, a person is subject to statutory disqualification by operation of Exchange Act Section 3(a)(39)").

II. Procedural History

On July 28, 2014, FINRA's Department of Enforcement filed a nine-cause complaint against Newport and the individuals identified above. The complaint alleged that Newport (acting through Leone, La Barbera, Levy, Costanzo, and Bartelt) engaged in excessive trading and churning; that Newport (acting through LaBarbera) made unsuitable recommendations; and that Newport failed adequately to supervise Leone, La Barbera, Levy, and Costanzo.

Arena and Luckey settled the charges against them.³ Bartelt defaulted after failing to file an answer or appear at the initial pre-hearing conference, and Levy and Costanzo defaulted after failing to appear at the final pre-hearing conference and subsequent show-cause hearing. Subsequently, a FINRA hearing officer (the "Hearing Officer") issued a default decision against Levy, Costanzo, and Bartelt (the "Defaulting Respondents") finding that they engaged in unsuitable trading in customer accounts and churned customer accounts. Each of the Defaulting Respondents was barred and ordered to pay restitution and a fine.

Newport, Leone, and La Barbera proceeded to a hearing before a FINRA hearing panel. On November 5, 2015, the hearing panel commenced a 19-day hearing and heard from more than 30 witnesses, including Leone and eight of his customers; La Barbera and three of his customers; and ten customers of Levy, Costanzo, and Bartelt. The hearing panel issued a decision against Newport, Leone, and La Barbera on October 17, 2016.

The hearing panel found that the testimony of all of the customers who testified was "highly credible," while the panel "did not find either Leone or La Barbera to be a credible witness." Based on this and other evidence introduced during the hearing, the panel found that Newport, Leone, and La Barbara excessively traded and churned 21 customer accounts; that Newport and La Barbera made qualitatively unsuitable recommendations; and that Newport failed reasonably to supervise Leone, LaBarbera, Levy, and Costanzo. The hearing panel ordered that Newport be expelled, pay a \$1 million fine, and pay (jointly and severally with Leone and La Barbera) \$853,617.04 in restitution to customers and approximately \$40,353.38 in costs; the panel also barred Leone and La Barbera from associating with any FINRA member in any capacity, fined Leone \$400,000, and fined La Barbera \$125,000.

Newport, Leone, and La Barbera appealed to the FINRA's National Adjudicatory Council (the "NAC"). During oral argument, Newport conceded that it was not contesting its liability or the order to pay a fine and restitution. Rather, Newport claimed that the expulsion was impermissibly punitive because the firm was already out of business and that the expulsion placed an undue burden on competition because it would require former Newport representatives

³ Order Accepting Luckey Settlement, *Newport Coast Sec., Inc.*, Proceeding No. 012030564701 (Aug. 4, 2015) (finding a failure to supervise and suspending Luckey from associating with any FINRA member firm in a principal capacity for 14 months and imposing a \$15,000 fine); Order Accepting Arena Settlement, *Newport Coast Sec., Inc.*, Proceeding No. 012030564701 (Oct. 20, 2015) (finding a failure to supervise and a failure to disclose liens and suspending Arena from associating with any FINRA member firm in a principal capacity for 23 months and from associating with any member firm in any capacity for 10 business days).

“to face the Taping Rule.”⁴ The NAC disagreed and affirmed the hearing panel’s findings of liability against all three respondents and the imposition of sanctions, except it reduced Newport’s fine to \$403,000, Leone’s fine to \$185,000, and La Barbera’s fine to \$125,000 while eliminating their ability to offset these amounts by any restitution paid. Only Newport appealed.

III. Analysis

Under the Securities Exchange Act of 1934, we may sustain FINRA’s sanctions only if we first determine that the applicant engaged in the conduct FINRA found; that the conduct violates the provisions FINRA found it to have violated; and that those provisions are, and were applied in a manner, consistent with the purposes of the Exchange Act.⁵ We base our findings on an independent review of the record and apply the preponderance of the evidence standard.⁶ Here, the record establishes that FINRA’s findings of liability should be sustained.

A. Newport has waived any arguments on the merits.

At the outset, we note that Newport has waived any challenge to the findings of violations. Since the hearing panel issued its decision, Newport has raised only constitutional and procedural objections and objections to the appropriateness of expelling it from FINRA membership. Newport did not challenge the findings of violations when it appealed the hearing panel’s decision to the NAC, and it does not challenge the findings of violations on appeal to the Commission. Under the circumstances, we hold that Newport has waived any arguments regarding the findings of violations or the appropriate sanctions except with respect to its expulsion from FINRA membership.⁷ Nonetheless, consistent with our standard of review discussed above, we review FINRA’s findings of violations before considering the expulsion.

⁴ See *infra* notes 85–87 and accompanying text (discussing the Taping Rule).

⁵ Exchange Act Section 19(e)(1), 15 U.S.C. § 78s(e)(1).

⁶ *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *1, *9 (May 27, 2011), *aff’d*, 693 F.3d 251 (1st Cir. 2012).

⁷ Rules of Practice 420(c) (“The application [for review] shall identify the determination complained of and set forth . . . a brief statement of the alleged errors in the determination and supporting reasons therefor.”), 450(b) (requiring that “[e]ach exception to the findings or conclusions being reviewed shall be stated succinctly [and] supported by citation to the relevant portions of the record . . . and by concise argument . . .”), 17 C.F.R. §§ 201.420(c), 450(b); see also *Canady v. SEC*, 230 F.3d 362, 362–63 (D.C. Cir. 2000) (upholding Commission’s conclusion that respondent “waived [a] defense by failing to argue it”); *Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, at *19 & n.115 (Feb. 20, 2015) (explaining that “arguments for reversal not made in the opening brief” are subject to waiver).

B. The record supports FINRA’s finding that Newport is liable for its registered representatives’ excessive trading, churning, and qualitatively unsuitable recommendations.

FINRA found that Newport (acting through its representatives) excessively traded in customers’ accounts in violation of NASD Rule 2310, NASD IM-2310-2, and FINRA Rule 2111; churned customer accounts in violation of Exchange Act Section 10(b), Rule 10b-5 thereunder, NASD Rule 2120, and FINRA Rule 2020; and made qualitatively unsuitable recommendations in violation of NASD Rule 2310. FINRA found further that, by committing those violations, Newport also violated NASD Rule 2110 and FINRA Rule 2010.⁸ The record supports FINRA’s findings that Newport is liable for these violations because, as described below, its representatives engaged in this misconduct in the course of their employment at Newport, and Newport is “accountable for the misconduct of its associated persons because it is through such persons that a firm acts.”⁹

1. The record supports FINRA’s finding that Newport (through its representatives) excessively traded in customer accounts.

FINRA found that Newport (acting through Leone, La Barbera, and the Defaulting Respondents) violated NASD Rules 2310 and 2110, NASD IM-2310-2, and FINRA Rules 2111 and 2010 by excessively trading in 21 customer accounts. These rules provide that a registered representative may recommend a purchase or sale of a security only if the representative “ha[s] reasonable grounds for believing that the recommendation is suitable for such customer.”¹⁰ One basis for violating these rules is if “the level of trading recommended by the representative is

⁸ NASD Rule 2110 and FINRA Rule 2010 are identical. They both state that “[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.” A violation of another NASD or FINRA rule constitutes a violation of Rule 2110 and Rule 2010. *See, e.g., Stephen J. Gluckman*, Exchange Act Release No. 41628, 1999 WL 507864, at *6 (July 20, 1999). We find that NASD Rule 2110 and FINRA Rule 2010 are consistent with the purposes of the Exchange Act because they reflect Section 15A(b)(6)’s mandate that FINRA have rules to “promote just and equitable principles of trade” and “protect investors and the public interest.” 15 U.S.C. § 78o-3(b)(6). As discussed below, FINRA applied those rules in a manner consistent with the Exchange Act’s purposes by finding that Newport violated other NASD and FINRA rules by making unsuitable recommendations, excessively trading and churning customer accounts, and failing to supervise adequately.

⁹ *SIG Specialists, Inc.*, Exchange Act Release No. 51867, 2005 WL 1421103, at *7 (June 17, 2005) (finding firm liable for NYSE rules violations committed by firm’s specialist); *cf. SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1249 (11th Cir. 2012) (holding that investment firm is liable under the principles of *respondeat superior* for acts of its brokers “so long as they acted within the scope of their authority”); *Cummings v. Paramount Partners, LP*, 715 F. Supp. 2d 880, 906 (D. Minn. 2010) (imposing securities fraud liability on a limited partnership because it “is an inanimate entity that can act only through its agents”).

¹⁰ *See, e.g., Cody*, 2011 WL 2098202, at *9 (quoting NASD Rule 2310).

excessive in light of the customer’s investment needs and objectives.”¹¹ Excessive trading occurs when a representative: (a) has control, formal or de facto, over the trading in an account and (b) the level of trading in that account is inconsistent with the customer’s objectives and financial situation.¹² The record supports FINRA’s finding that both elements were met here.

a. Newport’s representatives exercised de facto control over customer accounts.

Newport did not permit formal discretionary accounts for its customers, but a registered representative’s de facto control over an account “may be established when the customer relies on the representative such that the representative controls the volume and frequency of transactions.”¹³ Here, the evidence shows that Leone, La Barbera, and the Defaulting Respondents exercised such control over the relevant customer accounts.

FINRA based its finding that Leone, La Barbera, and the Defaulting Respondents exercised de facto control on the testimony of the 21 customers at issue. FINRA found their testimony to be credible, and we grant that credibility determination “considerable deference.”¹⁴ Newport does not challenge that credibility determination, and we find no basis for overturning it.

As FINRA explained, the 21 customers testified consistently that they followed their representatives’ trading recommendations and that the representatives controlled the trading in

¹¹ *Id.* (describing how excessive trading violates suitability requirements) (quoting *F.J. Kaufman & Co. of Va.*, Exchange Act Release No. 27535, 1989 WL 259961, at *3 (Dec. 13, 1989)); *see also John M. Reynolds*, Exchange Act Release No. 30036, 1991 WL 288500, at *2 (Dec. 4, 1991) (“Excessive trading may be thought of as quantitative unsuitability.”).

¹² *See, e.g., Cody*, 2011 WL 2098202, at *12 (citing *Harry Glikzman*, Exchange Act Release No. 42255, 1999 WL 1211765, at *2 (Dec. 20, 1999)).

¹³ *Id.* at *12 (citing cases).

¹⁴ *William Scholander*, Exchange Act Release No. 77492, 2016 WL 1255596, at *8 n.45 (Mar. 31, 2016), *petition denied sub nom. Harris v. SEC*, 712 F. App’x 46 (2d Cir. 2017); *see also, e.g., Jon R. Butzen*, Exchange Act Release No. 36512, 1995 WL 699189, at *2 & n.7 (Nov. 27, 1995) (“[T]he credibility determination of the initial decision maker [in a FINRA disciplinary proceeding] is entitled to considerable weight and deference, since it is based on hearing the witnesses’ testimony and observing their demeanor.”).

their accounts.¹⁵ Several customers also testified about unauthorized trading in their accounts.¹⁶ Leone also arranged for his customers' accounts to be approved for trading on margin and for day trading, despite his customers' consistent testimony that they were opposed to such methods.¹⁷ We therefore find that the evidence supports FINRA's conclusion that Leone, La Barbera, and the Defaulting Respondents exercised de facto control over their customers' accounts.¹⁸

b. Newport's representatives excessively traded.

In determining whether a broker has excessively traded in a customer's account, we consider the number and frequency of trades in the customer's account; the customer's investment objectives and financial condition, age, and retirement status; and the existence of unauthorized trades.¹⁹ The measures we have used in assessing the frequency of trading include an account's turnover rate and cost-to-equity ratio during the relevant period. "The turnover rate represents the number of times in one year that a portfolio of securities is exchanged for another portfolio of securities" and is calculated "by dividing the total [account] purchase[s] by the

¹⁵ See, e.g., *Cody*, 2011 WL 2098202, at *12 (stating that "control may be established when the customer relies on the representative such that the representative controls the volume and frequency of transactions"); *Joseph J. Barbato*, Exchange Act Release No. 7638, 1999 WL 58922, at *12 (Feb. 10, 1999) (concluding that respondent exercised de facto control where client "testified that he placed his trust and confidence in [respondent] and allowed him to decide what to buy or sell in the account"); *Donald A. Roche*, Exchange Act Release No. 38742, 1997 WL 328870, at *7 n.14 (June 17, 1997) (concluding that "[t]he evidence strongly show[ed] Roche exercised de facto control . . . , as the customers routinely followed his recommendations"); *Michael David Sweeney*, Exchange Act Release No. 29884, 1991 WL 716756, at *4 (Oct. 30, 1991) (finding control where customers routinely followed broker's recommendations).

¹⁶ See, e.g., *Sandra K. Simpson*, Exchange Act Release No. 45923, 2002 WL 987555, at *15 (May 14, 2002) (explaining that de facto control exists when a customer is incapable of controlling the account because of unauthorized trading); *Frederick C. Heller*, Exchange Act Release No. 31696, 1993 WL 8588, at *2 n.7 (Jan. 7, 1993) (finding that a representative exercised control where the customers "were not consulted, nor typically even made aware of, the particular trades executed in their account until well after the fact"); *Reynolds*, 1991 WL 288500, at *2 (finding control where the broker did "not claim that [customers] suggested particular transactions on their own or approved particular transactions before their execution").

¹⁷ Cf. *Edgar B. Alacan*, Exchange Act Release No. 49970, 2004 WL 1496843, *5 (July 6, 2004) (finding unauthorized trading where applicant traded "on margin when margin trading had not been authorized").

¹⁸ Cf. *Newburger, Loeb & Co. v. Gross*, 563 F.2d 1057, 1070 (2d Cir. 1977) (noting that "determination of whether [client] exercised control over the account involved a question of fact, which turned largely upon the court's assessment of the witnesses' credibility").

¹⁹ See *Ralph Calabro*, Exchange Act Release No. 75076, 2015 WL 3439152, at *8 (May 29, 2015) (citing cases).

average account equity and annualizing the number.”²⁰ The cost-to-equity ratio “measures the amount an account has to appreciate annually just to cover commissions and other expenses” and is obtained “by dividing total expenses by average monthly equity.”²¹ And “[w]hile there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading,” we have held that “a turnover rate of 6 or a cost-to-equity ratio in excess[] of 20% generally indicates that excessive trading has occurred.”²² Leone’s, La Barbera’s, and the Defaulting Respondents’ trading far exceeded these thresholds—the lowest annualized turnover rate in the relevant accounts was 11 and the lowest annualized cost-to-equity ratio was 50%.

None of the representatives’ customers indicated investment objectives that would support such high levels of trading. The customers at issue were all retail investors with limited investment experience. They generally sought to invest with minimal risk, and none sought to invest in high-risk investments, to speculate, or to trade at the quantity and pace that their representatives did.²³ Several customers were also older, and at or near retirement.²⁴ And, as noted above, Leone, La Barbera, and the Defaulting Respondents all engaged in unauthorized trading.²⁵ Accordingly, we find that Newport (acting through Leone, La Barbera, and the

²⁰ *Roche*, 1997 WL 328870, at *7 n.6.

²¹ *Peter C. Bucchieri*, Exchange Act Release No. 37218, 1996 WL 254677, at *1 & n.4 (May 14, 1996).

²² *Daniel Richard Howard*, Exchange Act Release No. 46269, 2002 WL 1729157, at *3 (July 26, 2002); *see also SEC v. Howard*, 77 F. App’x 2, 3 (1st Cir. 2003) (per curiam) (finding that “the case law supports the SEC’s characterization of these turnover rates and cost-to-equity ratios as reflecting excessive trading” where the Commission had found excessive trading where the turnover rate was approximately 8.5 and the annualized cost-to-equity ratio was 54%).

²³ *See, e.g., Cody*, 2011 WL 2098202, at *13 (stating that “[c]ustomer investment objectives and financial situation are the benchmarks for evaluating whether the level of trading in any account is appropriate.”); *Howard*, 2002 WL 1729157, at *2 (observing that account activity “must be consistent with the customer’s investment objectives and needs”).

²⁴ *See, e.g., Cody*, 2011 WL 2098202, at *13 (finding excessive trading where accounts at issue “were to be used to fund retirement, demonstrating a need to protect principal and limit risk-taking”); *Barbato*, 1999 WL 58922, at *12 (finding that “[f]or an individual who is dependent on the account for retirement,” rate of trading was “clearly excessive”); *Clyde J. Bruff*, Exchange Act Release No. 40583, 1998 WL 730586, at *3 (Oct. 21, 1998) (considering, among other factors, client’s age for purposes of suitability).

²⁵ *See Simpson*, 2002 WL 987555, at *14 (explaining that finding of excessive trading was “bolstered by the unauthorized nature of many of the trades”).

Defaulting Respondents) engaged in excessive trading in 21 customer accounts in violation of NASD Rules 2310 and 2110, NASD IM-2310-2, and FINRA Rules 2111 and 2010.²⁶

c. FINRA’s finding that Newport excessively traded in customer accounts is consistent with the purposes of the Exchange Act.

Exchange Act Section 15A(b)(6) requires that FINRA design its rules to prevent fraudulent and manipulative acts and practices, to “promote just and equitable principles of trade,” and to “protect investors and the public interest.”²⁷ NASD Rule 2310, NASD IM-2310-2, and FINRA Rule 2111 are consistent with these purposes because they require that members make suitable recommendations.²⁸ FINRA applied these rules in a manner consistent with the purposes of the Exchange Act because a preponderance of the evidence supports FINRA’s conclusion that Newport made unsuitable recommendations in violation of these rules.

2. The record supports FINRA’s finding that Newport churned its customers’ accounts.

FINRA also found that Newport (acting through Leone, La Barbera, and the Defaulting Respondents) violated Exchange Act Section 10(b), Exchange Act Rule 10b-5 thereunder, NASD Rules 2120 and 2110, and FINRA Rules 2020 and 2010 by churning 21 of Leone’s, La Barbera’s, and the Defaulting Respondents’ customer accounts. Churning is excessive trading where the representative “enters into transactions and manages a client’s account for the purpose of generating commissions and in disregard of his client’s interests.”²⁹ Courts have explained churning as “a shorthand expression for a type of fraudulent conduct in a broker-customer relationship where the broker ‘overtrades’ a relying customer’s account to generate inflated sales commissions.”³⁰ In other words, churning is excessive trading done with “scier on the part of

²⁶ See, e.g., *William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752, at *12–15 (July 2, 2013) (affirming FINRA’s finding that excessive trading violated NASD Rules 2310 and 2110), *petition denied sub nom. Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014); *Bernard G. McGee*, Exchange Act Release No. 80314, 2017 WL 1132115, at *10–11 (Mar. 27, 2017) (affirming FINRA’s finding that unsuitable recommendations violated NASD IM-2310-2 and FINRA Rule 2010), *petition denied*, 733 F. App’x 571 (2d Cir. 2018).

²⁷ 15 U.S.C. § 78o-3(b)(6).

²⁸ See, e.g., *Fuad Ahmed*, Exchange Act Release No. 81759, 2017 WL 4335036, at *11 (Sept. 28, 2017) (finding that NASD Rule 2310, which is identical to FINRA Rule 2111, and NASD IM-2310-2 are consistent with the purposes of the Exchange Act).

²⁹ *Murphy*, 2013 WL 3327752, at *15 (quoting *Roche*, 1997 WL 328870, at *4); *accord Al Rizek*, Exchange Act Release No. 41725, 1999 WL 600427, at *5 (Aug. 11, 1999), *aff’d*, 215 F.3d 157 (1st Cir. 2000); see also *Carras v. Burns*, 516 F.2d 251, 258 (4th Cir. 1975) (recognizing that churning “is a deceptive device made actionable by § 10(b) of the Securities Exchange Act and S.E.C. Rule 10b-5”).

³⁰ *Craighead v. E.F. Hutton & Co., Inc.*, 899 F.2d 485, 489 (6th Cir. 1990).

the broker.”³¹ Scienter may be shown by proof that the broker acted recklessly.³² We have found scienter where a “very high level of commissions and the resulting high cost-to-equity ratio” shows that the broker’s “overriding goal was generating commissions” and therefore the broker must have known he was acting in reckless disregard of his customer’s interests.³³ We find that the record supports FINRA’s conclusion that Leone, La Barbera, and the Defaulting Respondents (and therefore Newport) engaged in churning by managing their customers’ accounts for the purpose of generating commissions and in disregard of their clients’ interests.

The record establishes that, for eight of Leone’s customers, Leone traded for the purpose of generating commissions and in disregard of his clients’ interests because they would have needed to have earned more than 100% per year to break even.³⁴ Leone also concealed from his customers that he was charging commissions as high as \$1,000 or \$5,000 per trade.³⁵ And Leone generated a significant portion of his commissions—between approximately 25% and 50%—during the relevant period from just one or two customers at a time.³⁶

The record also establishes that, for three of La Barbera’s customers, La Barbera traded for the purpose of generating commissions and in disregard of his clients’ interests. We agree with FINRA that La Barbera’s high volume of trades, commissions, and other charges relative to the size of these three accounts made it “extremely unlikely that [these customers] would be able to break even, much less earn any profit.”³⁷ La Barbera, like Leone, also attempted to conceal his commissions and markups from his customers and engaged in unauthorized trading.

The record establishes further that the Defaulting Respondents traded their customers’ accounts with the primary purpose of generating commissions, mark-ups, and mark-downs for their own benefit. Levy’s three customers would have needed to earn between 50.7% and 68.82% to break even; Costanzo’s four customers would need to have earned between 100.02% and 120.71%; and Bartelt’s three customers would need to have earned between 52.96% and 200.49%. These cost-to-equity ratios demonstrate, at the least, that the Defaulting Respondents were acting in reckless disregard of their customers’ interests.

³¹ *Murphy*, 2013 WL 3327752, at *15.

³² *Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 775 n.6 (9th Cir. 1984).

³³ *Id.*

³⁴ *See, e.g., Murphy*, 2013 WL 3327752, at *15 (finding scienter necessary for churning because the “volume and frequency” of the trading was “difficult to explain except as Murphy’s seeking to maximize his own commissions [and] in disregard of [his customer’s] interests”).

³⁵ *See id.* at *16 (finding evidence of churning from respondent’s attempts to mislead his customer about his trading); *see also Phillip J. Milligan*, Exchange Act Release No. 61790, 2010 WL 1143088, at *5 (Mar. 26, 2010) (“[A]ttempts to conceal misconduct indicate scienter.”).

³⁶ *See, e.g., Murphy*, 2013 WL 3327752, at *15–16 (finding evidence of churning where respondent’s trading in one customer’s account was responsible for 59% of his commissions).

³⁷ *Roche*, 1997 WL 328870, at *4 (finding that Roche churned in customer accounts).

Accordingly, we find that Leone, La Barbera, and the Defaulting Respondents acted with the scienter necessary to support a finding that they churned their customers' accounts. "Instead of managing [the customers'] account[s] in a manner consistent with [their] true financial profile[s] and risk tolerance[s]," they "pursued excessive trading that primarily benefited" themselves (by increasing Newport's, and therefore their own, commissions).³⁸ Each trade defrauded customers of returns on their investments by placing the representatives' own profits ahead of the customers' best interests. Newport (through Leone, La Barbera, and the Defaulting Respondents) thus employed a device, scheme, or artifice to defraud and engaged in an act, practice, or course of business that operated as a fraud.³⁹ Newport is thus liable for churning customer accounts in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5(a) and (c), NASD Rules 2120 and 2110, and FINRA Rules 2020 and 2010.⁴⁰

FINRA applied Exchange Act Section 10(b) and Rule 10b-5 thereunder consistently with the purposes of the Exchange Act. Exchange Act Section 2 states that regulation of the securities industry is necessary "to insure the maintenance of fair and honest markets in [securities] transactions."⁴¹ Here, FINRA acted consistently with the purposes of the Exchange Act in applying Section 10(b) and Rule 10b-5 to Newport's misconduct because Newport's securities transactions put investors at risk.⁴² NASD Rule 2120 and FINRA Rule 2020 are also designed to prevent fraud and are therefore consistent with the Exchange Act's purposes.⁴³ And FINRA

³⁸ *Calabro*, 2015 WL 3439152, at *27; *see also Michael T. Studer*, Exchange Act Release No. 50543A, 2004 WL 2735433, at *5 (Nov. 30, 2004) (finding that "[t]he generation of commissions as a goal overriding the client's interests evidences scienter in churning"); *Roche*, 1997 WL 328870, at *4 (finding that the motivation to maximize a broker's remuneration in disregard of the interests of the customer "creates the element of scienter necessary for a violation of the antifraud provisions of the securities laws").

³⁹ 17 C.F.R. § 240.10b-5(a), (c) (prohibiting any person in connection with the purchase or sale of securities from "employ[ing] any device, scheme, or artifice to defraud" or "engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit"); *see also Merrimac Corp. Sec., Inc.*, Exchange Act Release No. 86404, 2019 WL 3216542, at *19 (July 17, 2019) ("It is well-established that a firm may be held accountable for the misconduct of its associated persons because it is through such persons that a firm acts.") (internal quotation marks, alteration, and citation omitted).

⁴⁰ *See Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir.1983) (observing that "[c]hurning, in and of itself, may be a deceptive and manipulative device under section 10(b)").

⁴¹ 15 U.S.C. § 78b.

⁴² *See, e.g., Ahmed*, 2017 WL 4335036, at *18 (finding that Exchange Act Section 10(b) and Rule 10b-5 were applied consistently with the purposes of the Exchange Act).

⁴³ *See, e.g., id.* at *11 (finding FINRA Rule 2020 to be consistent with the Exchange Act's purposes); *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 WL 627346, at *11 (Feb. 13, 2015) (same as to NASD Rule 2120).

applied those rules in a manner consistent with these purposes because the evidence supports FINRA’s findings that Newport committed securities fraud under those rules.⁴⁴

3. The record supports FINRA’s finding that Newport made qualitatively unsuitable recommendations regarding certain exchange-traded products.

FINRA also found that Newport (acting through La Barbera, Costanzo, and Levy) violated NASD Rules 2310 and 2110 and FINRA Rule 2010 by making qualitatively unsuitable recommendations to its retail investors. As we have long held, a representative’s recommendation carries the implicit representation that it was “responsibly made on the basis of actual knowledge and careful consideration.”⁴⁵ This is because “a broker cannot determine whether a recommendation is suitable for a specific customer unless the broker understands the risks and rewards inherent in that recommendation.”⁴⁶ A recommendation is not suitable if the broker “fails so fundamentally to comprehend the consequences of his own recommendation that such recommendation is unsuitable for any investor, regardless of the investor’s wealth, willingness to bear risk, age, or other individual characteristics.”⁴⁷

La Barbera recommended approximately 26 purchases of seven leveraged or inverse exchange-traded funds (“ETFs”) to a customer between March 2009 and August 2010 without a reasonable basis for having done so.⁴⁸ The registration statements for the ETFs La Barbera recommended all described them as high risk investments intended for sophisticated investors. Yet La Barbera’s testimony showed that he possessed almost no understanding of the ETFs or their risks. When asked why he was recommending these products to his clients, La Barbera

⁴⁴ See, e.g., *Ahmed*, 2017 WL 4335036, at *17 (stating that, “in finding Respondents liable for securities fraud under these rules,” FINRA applied FINRA Rule 2020 consistently with the Exchange Act’s purposes); *Lane*, 2015 WL 627346, at *11 (finding that FINRA applied NASD Rule 2120 in a manner consistent with the purposes of the Exchange Act because FINRA “properly found that Marcus Lane fraudulently charged excessive markups”).

⁴⁵ *Cody*, 2011 WL 2098202, at *9 (quoting *Alexander Reid & Co., Inc.*, Exchange Act Release Act No. 6727, 1962 WL 68464, at *4 (Feb. 8, 1962)); see also *Michael Frederick Siegel*, Exchange Act Release No. 58737, 2008 WL 4528192, at *8 n.23 (Oct. 6, 2008) (finding that under NASD Rule 2310 registered representatives must have a reasonable and adequate basis for any recommendations they make), *aff’d in relevant part*, 592 F.3d 147 (D.C. Cir. 2010); cf. *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175, 191–92 (2015) (observing that “liability may result from omission of facts—for example, the fact that the speaker failed to conduct any investigation—that rebut the recipient’s predictable inference” (citing RESTATEMENT (SECOND) OF TORTS § 539 cmt. a (1976))).

⁴⁶ *Cody*, 2011 WL 2098202, at *10 (quoting *F.J. Kaufman & Co.*, 1989 WL 259961, at *3).

⁴⁷ *Siegel*, 2008 WL 4528192, at * (citation omitted).

⁴⁸ The ETFs were (1) Direxion Daily Financial Bull 3X Shares (FAS); (2) Direxion Daily Energy Bull 3X Shares (ERX); (3) Direxion Daily Small Cap Bear 3X Shares (TZA); (4) Direxion Daily Financial Bear 3X Shares (FAZ); (5) ProShares UltraShort Financials (SKF); (6) ProShares UltraShort Real Estate (SRS); and (7) ProShares Ultra DJ-UBS Crude Oil (UCO).

could not recall. He stated only that “obviously it was to see some sort of appreciation at the time based on the specific indices that these were related to and events going on in those indices.” And when asked about his strategy for recommending a particular ETF, he could recall only that “during that period of time it was heavily recommended, not only by myself but throughout the industry.” However, he did not provide any explanation of how the fact that the ETF was recommended by others provided him a reasonable basis on which to make his own recommendations. We have held previously that a broker lacks a reasonable basis for recommending a security if he is “unaware of his strategy’s implications” and therefore does not “understand its consequences.”⁴⁹ La Barbera did not understand the ETFs he recommended including their risks; as a result, we find that La Barbera (and thus Newport) did not have a reasonable basis for recommending the ETFs.⁵⁰

In addition to having a reasonable basis for making a recommendation, a broker must also assess whether an investment recommendation is suitable for the specific customer to whom it is made.⁵¹ Such customer-specific suitability requires that a recommendation be consistent with the customer’s best interests and financial situation.⁵² A broker cannot be satisfied that a recommendation is suitable without disclosing the risks of the security to the customer because the broker must be satisfied that the customer is “willing to take those risks.”⁵³

La Barbera, Costanzo, and Levy did not comply with these requirements when recommending purchases of VXX, a futures-index-linked exchange-traded note, to three customers. VXX’s prospectus indicated that it “may be a suitable investment” if the investor was “willing to accept the risk of fluctuations in volatility in general and in the prices of futures contracts on the VIX Index in particular.” Newport’s former chief compliance officer testified that the product was “so complex in nature that it is really hard to determine the underlying positions and whether leverage was actually used to imitate the VIX, which is . . . an options volatility index.” And Costanzo conceded during his investigative testimony that it was his understanding that VXX was unsuitable for retail customers and that he did not understand it when he recommended it. Nonetheless, Costanzo, La Barbera, and Levy all recommended VXX

⁴⁹ *F.J. Kaufman & Co.*, 1989 WL 259961, at *5.

⁵⁰ *Cf. Cody*, 2011 WL 2098202, at *10 (finding broker did not have a reasonable basis for recommending securities where, “[b]y his own admission, [he] did not understand their features”).

⁵¹ *See, e.g., Murphy*, 2013 WL 3327752, at *10 (explaining that “[a] registered representative can violate the suitability rule if he or she inadequately assesses whether the recommendation is suitable for the specific investor to whom the recommendation is directed” (internal quotation marks omitted)); *see also Katz v. SEC*, 647 F.3d 1156, 1164 (D.C. Cir. 2011) (affirming Commission’s finding that Katz had made unsuitable investment recommendations by failing “to tailor her recommendations to [her customers’] profiles”).

⁵² *See, e.g., McGee*, 2017 WL 1132115, at *10; *Cody*, 2011 WL 2098202, at *11; *Dane S. Faber*, Exchange Act Release No. 49216, 2004 WL 239507, at *6 (Feb. 10, 2004).

⁵³ *Patrick G. Keel*, Exchange Act Release No. 31716, 1993 WL 12348, at *2 (Jan. 11, 1993).

to retail customers. These customers testified that they never had the risks of VXX explained to them. Accordingly, we find that these recommendations were not suitable for these customers.⁵⁴

We thus find that Newport (acting through La Barbera, Costanzo, and Levy) made unsuitable recommendations in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010. We find that those rules are, and were applied in a manner, consistent with the purposes of the Exchange Act for the reasons discussed above with respect to Newport's excessive trading.⁵⁵

* * *

Newport's liability for the above violations stems from its registered representatives' misconduct. As discussed above, the record establishes that Newport's associated persons—Leone, La Barbera, Levy, Costanzo, and Bartelt—committed the violations while acting as registered representatives for Newport. Because these registered representatives were acting well within the scope of their employment, we find that Newport is liable for their misconduct.⁵⁶

C. Newport failed to supervise reasonably.

Finally, FINRA found that Newport violated NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to supervise reasonably the trading of Leone, La Barbera, Costanzo, and Levy. NASD Rule 3010 required member firms to “establish and maintain” a supervisory system “that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules.” The “presence of procedures alone is not enough” because “[w]ithout sufficient implementation, guidelines and strictures do not assure compliance.”⁵⁷ The duty of supervision “includes the responsibility to investigate ‘red flags’ that suggest that misconduct may be occurring and to act upon the results of such investigation.”⁵⁸

⁵⁴ See *id.* (finding recommendation unsuitable because applicant could not have had a reasonable basis for his recommendation since he “at no time disclosed to” his customer the risks of the investment and thus “could not have been satisfied” she “was willing to assume them”).

⁵⁵ See *supra* notes 27–28.

⁵⁶ See *supra* note 9; *cf. Makor Issues & Rights, Ltd. v. Tellalabs Inc.*, 513 F.3d 702, 708 (7th Cir. 2008) (“[D]octrines of respondeat superior and apparent authority remain applicable to suits for securities fraud.”).

⁵⁷ *Rita H. Malm*, Exchange Act Release No. 35000, 1994 WL 665963, at *4 n.17 (Nov. 23, 1994).

⁵⁸ *Studer*, 2004 WL 2735433, at *6; see also, e.g., *Merrimac Corp. Sec.*, 2019 WL 3216542, at *18; *Murphy*, 2013 WL 3327752, at *18.

Supervisors must “respond with the utmost vigilance when there is any indication of irregularity,” and must “take decisive action when they are made aware of suspicious circumstances.”⁵⁹ Newport failed to meet this standard.

Newport’s senior management knew about red flags surrounding its representatives’ trading. They received exception reports from Newport’s clearing firms showing that the trading in Leone’s, La Barbera’s, Levy’s, and Costanzo’s customers’ accounts repeatedly exceeded specified thresholds. Indeed, Newport’s chief compliance officer (“CCO”) testified that he knew about Leone’s, La Barbera’s, Levy’s, and Costanzo’s excessive trading and the firm’s failure to respond. For example, he admitted that he knew Leone was excessively trading customers’ accounts and that he never directed Arena or the trading desk to stop Leone from doing so. Nor was he aware of any other member of Newport’s management that did so.

The CCO also explained that, although Newport placed its representatives on heightened supervision in May 2012 in response to FINRA’s investigation, he did not order the firm’s compliance department to review or investigate those representatives’ customer accounts. He reasoned that “there weren’t any secrets about what was taking place with these” registered representatives, that Newport’s then-CEO “was fully cognizant of what was going on,” and that he didn’t “know what it would have accomplished other than to paper some files, but I don’t think it would have resulted in any changes.” The CCO testified further that Newport had received numerous customer complaints about La Barbera, Costanzo, and Levy and that he informed the firm’s CEO about them. But the CCO had no ability to limit the trading of these representatives or terminate them because, according to him, Newport’s CEO “ruled with an iron fist” and “there wasn’t anything that was said or done without her approval.” The CCO acknowledged that Newport’s supervisory structure “was less than adequate.”

We thus agree with FINRA that Newport engaged in ‘unreasonable inaction’ in the face of red flags indicative of excessive trading and churning.” Accordingly, we affirm FINRA’s finding that Newport’s conduct violated NASD Rules 3010 and 2110 and FINRA Rule 2010.⁶⁰

We find further that NASD Rule 3010 is, and was applied in a manner, consistent with the purposes of the Exchange Act. We have found previously that Rule 3010 is consistent with the purposes of the Exchange Act, under which the rules of a registered securities association must “prevent fraudulent and manipulative acts and practices, [and] promote just and equitable principles of trade.”⁶¹ As we have explained, the Commission “has long emphasized that the responsibility of broker-dealers to supervise their employees is a critical component of the

⁵⁹ *KCD Fin. Inc.*, Exchange Act Release No. 80340, 2017 WL 1163328, at *9 (Mar. 29, 2017); *see also Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 WL 4336702, at *8 (Sept. 16, 2011) (“Once indications of irregularity arise, supervisors must respond appropriately.”).

⁶⁰ *See Robert E. Strong*, Exchange Act Release No. 57426, 2008 WL 582537, at *7 (Mar. 4, 2008) (finding that “the evidence establishes that Strong’s unreasonable inaction effectively nullified the supervisory system” in violation of NASD Rules 3010 and 2110).

⁶¹ *See, e.g., Merrimac Corp. Sec.*, 2019 WL 3216542, at *15, *22.

federal regulatory scheme.”⁶² Because a preponderance of the evidence supports FINRA’s finding that Newport’s supervisory system did not provide the firm’s customers protections against fraudulent and unfair trading practices, we find that FINRA applied Rule 3010 in a manner consistent with the purposes of the Exchange Act.⁶³

IV. Sanctions

Exchange Act Section 19(e)(2) requires that we sustain the sanctions FINRA imposed unless we find that they are “excessive or oppressive” or impose an unnecessary or inappropriate burden on competition.⁶⁴ Under this standard, we consider any aggravating or mitigating factors and whether the sanctions are remedial and not punitive.⁶⁵ We sustain FINRA’s order expelling Newport and imposing a \$403,000 fine and approximately \$853,000 in restitution.

In imposing sanctions, FINRA relied on its Sanctions Guidelines.⁶⁶ Although these Guidelines are not binding, they serve as a benchmark in conducting our review.⁶⁷ The Guidelines for excessive trading and churning recommend a fine of \$5,000 to \$110,000, and a suspension in any or all capacities for one month to two years.⁶⁸ When aggravating factors predominate, the Guidelines recommend a longer suspension or expulsion.⁶⁹ For unsuitable recommendations, the Guidelines recommend a fine of \$2,500 to \$110,000.⁷⁰ In egregious cases, the Guidelines recommend a suspension of any or all activities for longer than 90 days or an expulsion.⁷¹ For systemic supervisory failures occurring over an extended period, the Guidelines recommend fining a firm \$10,000 to \$292,000.⁷² When aggravating factors predominate, the Guidelines direct that a higher fine and expulsion be considered.⁷³ The Guidelines further

⁶² *Id.* at *22.

⁶³ *See, e.g., KCD Fin.*, 2017 WL 1163328, at *10 (finding that NASD Rule 3010 is, and was applied in a manner, consistent with the purposes of the Exchange Act).

⁶⁴ 15 U.S.C. § 78s(e)(2).

⁶⁵ *See Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007).

⁶⁶ FINRA Sanction Guidelines (Mar. 2017), http://www.finra.org/sites/default/files/2017_Sanction_Guidelines.pdf.

⁶⁷ *See John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *11 (June 14, 2013).

⁶⁸ Guidelines at 79.

⁶⁹ *Id.*

⁷⁰ *Id.* at 96.

⁷¹ *Id.*

⁷² *Id.* at 106.

⁷³ *Id.* at 107.

recommend imposing restitution to remediate misconduct.⁷⁴ The sanctions imposed here are consistent with these Guidelines, are remedial and not punitive or excessive or oppressive, and do not impose an unnecessary or inappropriate burden on competition.

A. We sustain FINRA’s order expelling Newport from FINRA membership.

1. Newport’s conduct was egregious, and the firm has a lengthy disciplinary history.

Newport admitted to the NAC that its “underlying conduct was egregious,” and the record supports that conclusion. As detailed above, Newport engaged in serious and extensive misconduct over a lengthy period. This misconduct included scienter-based antifraud violations.⁷⁵ Newport abused its customers’ trust and confidence by excessively trading and churning their accounts and by making qualitatively unsuitable recommendations. These were not isolated incidents; rather, they were repeated, years-long securities law violations committed against more than twenty customers by multiple representatives and across multiple offices.⁷⁶

Newport’s failure to respond to indications that misconduct was occurring was especially egregious. Exception reports repeatedly identified red flags about its representatives’ trading, but the firm took no action in response. Indeed, the firm’s CCO testified that Newport received numerous customer complaints about La Barbera, Costanzo, and Levy and that the firm’s CEO prevented him from disciplining them. Newport’s inaction harmed its customers by imposing unnecessary commissions, markups, and markdowns from excessive trading and churning. The firm benefited financially from this misconduct by retaining a portion of the commissions, markups, markdowns, and its customers suffered substantial losses.⁷⁷

⁷⁴ *Id.* at 4.

⁷⁵ *Id.* at 8 (Principal Consideration No. 13) (directing adjudicators to consider whether respondent’s misconduct was the result of an intentional act, recklessness, or negligence); *cf.* *David Henry Disraeli*, Advisers Act Release No. 8880, 2007 WL 4481515, at *15–16 (Dec. 21, 2007) (finding that respondent committed antifraud violations “egregiously and with a high degree of scienter” and that because antifraud violations are “especially serious” a bar “provides necessary protection for future investors”), *petition denied*, 334 F. App’x 334 (D.C. Cir. 2009).

⁷⁶ Guidelines at 7 (Principal Consideration No. 8) (directing adjudicators to consider whether respondent “engaged in numerous acts and/or a pattern of misconduct”).

⁷⁷ *Id.* at 7 (Principal Consideration No. 11) (directing adjudicators to consider whether the misconduct resulted in injury); *id.* at 8 (Principal Consideration No. 16) (directing adjudicators to consider whether the misconduct resulted in the potential for the respondent’s monetary gain).

Further aggravating Newport’s misconduct is its disciplinary history.⁷⁸ Newport claims that it had “no significant disciplinary history” when the hearing panel issued its decision. To the contrary, the firm settled five previous FINRA disciplinary actions. Three such settlements involved findings that the firm either failed to establish and maintain a reasonable supervisory system, failed to establish and implement reasonable policies and procedures, or failed to enforce its written supervisory procedures. The firm also settled a Commission administrative proceeding by consenting to findings that it failed to supervise a representative. This past misconduct does not represent “no significant disciplinary history” but rather “evidences a reckless disregard for regulatory requirements, investor protection, [and] market integrity.”⁷⁹

Newport complains that expulsion “is capital punishment” and “death to a firm.” But the courts have not held that the fact that a sanction is serious means that it is impermissible; rather, they have held that the Commission “must explain why imposing the most severe . . . sanction is, in fact, remedial.” Here, Newport’s trading, failures to supervise, and disciplinary history establish that the public must be protected from Newport in the future.

Given these factors, we agree with FINRA that “action is necessary in order to protect the investing public from Newport’s flagrant disregard of its regulatory responsibilities to its customers.”⁸⁰ Newport’s conduct “cannot be tolerated in an industry that depends on high standards of professional conduct.”⁸¹ Accordingly, we find that its continued membership would pose a threat to investors and that FINRA’s decision to expel Newport is not punitive or excessive or oppressive but rather is an appropriate remedial measure.

2. Newport’s challenges to its expulsion are unpersuasive.

Newport challenges its expulsion on essentially three grounds: (1) its expulsion is punitive because the firm is already out of business; (2) its expulsion subjects it to

⁷⁸ See *id.* at 2 (General Principle No. 2) (stating that adjudicators should “impos[e] progressively escalating sanctions on recidivists beyond those outlined in these guidelines, up to and including barring associated persons and expelling firms”); *id.* at 7 (Principal Consideration No. 1) (directing adjudicators to consider respondent’s relevant disciplinary history); *cf.* *Castle Sec. Corp.*, Exchange Act Release No. 52580, 2005 WL 2508169, at *5 (Oct. 11, 2005) (finding a firm’s disciplinary history “a significant aggravating factor and an important consideration”).

⁷⁹ *Meyers Assocs., L.P.*, Exchange Act Release No. 86497, 2019 WL 338709, at *9 (July 26, 2019) (quoting Guidelines at 3 (General Principle No. 3)).

⁸⁰ See, e.g., *McCarthy v. SEC.*, 406 F.3d 179, 188 (2d Cir. 2005) (“[T]he purpose of expulsion or suspension from trading is to protect investors, not to penalize brokers.”); see also *Mission Sec. Corp.*, Exchange Act Release No. 63453, 2010 WL 5092727, at *14 (Dec. 7, 2010) (“Applicants represent a clear danger to the investing public if they remain in the securities industry, and, as FINRA accurately observed in its decision, ‘expelling Mission and barring Biddick in all capacities are the only effective remedial sanctions.’”).

⁸¹ *Jay Frederick Keeton*, Exchange Act Release No. 31082, 1992 WL 213846, at *7 (Aug. 24, 1992).

inappropriately disproportionate treatment; and (3) its expulsion has collateral consequences for its former associated persons that impose an undue burden on competition and make the sanction “oppressive.”⁸² None of these arguments warrants setting aside the expulsion.

a. Newport’s expulsion is not punitive.

First, Newport argues that its expulsion should be vacated because FINRA has provided no remedial purpose for expelling a firm like itself that is “already out of business.”⁸³ But FINRA found that expulsion “serve[d] the remedial purpose of protecting investors who may be harmed by similar misconduct in the future if the firm was eligible for membership.” We agree that expulsion protects investors from Newport returning to business in the future.⁸⁴

Regardless of whether Newport would seek to reenter the industry, moreover, expelling the firm provides additional important protections for investors. Specifically, an expulsion triggers FINRA Rule 3170 (“the Taping Rule”). The Taping Rule requires certain member firms to record all telephone conversations with existing and prospective customers if a certain percentage of the firm’s registered persons have been employed by a firm “that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the SEC revoking its registration as a broker-dealer.”⁸⁵ In approving the Taping Rule, we found that its provisions would “discourage the revival of disciplined firms that have

⁸² In its opening brief, Newport wrote that the expulsion should be “stayed.” FINRA responded that Newport’s request should not be construed as a motion for a stay but rather as an objection to the sanction because the substance of Newport’s brief clarified that the firm sought only that the expulsion be “reduced or vacated.” Because Newport did not mention, let alone address, the standard for granting a stay and did not dispute FINRA’s interpretation in its reply brief, we construe Newport’s briefs not as seeking a stay but as objecting to the expulsion.

⁸³ On August 3, 2016, Newport filed a Form BDW, which broker-dealers must file to withdraw their registrations with the Commission, self-regulatory organizations, and state jurisdictions. In addition, on September 6, 2016, FINRA cancelled Newport’s licenses, membership, and registration for failure to pay outstanding fees owed to FINRA. On October 2, 2016, the Form BDW became effective and Newport’s registration was terminated. FINRA retains jurisdiction to commence an action against a member for two years after its resignation from, or termination or cancellation of, membership. FINRA By-Laws, Art. IV, § 6.

⁸⁴ Cf. *Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *8 & n.48 (Sept. 26, 2007) (finding that “[a] bar is necessary to protect the public interest because, absent a bar, there would be nothing to prevent Seghers from becoming an investment adviser to the Funds’ investors or others in the future”), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008); see also 15 U.S.C. § 78c(a)(39)(A) (defining statutory disqualification as including a company expelled from membership by a self-regulatory organization, but not including one that has had its membership cancelled).

⁸⁵ FINRA Rule 3170(a)(2)(A). FINRA may grant exemptions to the Taping Rule in “exceptional circumstances.” FINRA Rule 3170(d).

been barred by the industry or that have had their registrations revoked by the Commission.”⁸⁶ We explained that, “[i]n essence, firms that decide to hire significant numbers of employees from disciplined firms will be required to ensure a proper supervisory environment that protects investors and prevents fraudulent and manipulative telemarketing acts and practices.”⁸⁷ Thus, the purpose of the Taping Rule is remedial and not punitive as was FINRA’s determination on this record that it was necessary to expel Newport (which could trigger the rule).

Newport argues that expulsion is punitive because it may trigger the Taping Rule for some of its former representatives who move to another firm but who may not have engaged in misconduct. Expulsion and the Taping Rule are no less remedial in this situation. We have noted previously that, under the Taping Rule, “[t]he monitoring of registered persons’ telephone conversations will help to provide additional supervision of individuals who formerly worked at a disciplined firm where they were inadequately trained and supervised.”⁸⁸ Indeed, as discussed above Newport has a history of deficient supervision. We thus find that expelling Newport protects investors should Newport seek to reenter the industry and, because expulsion triggers the Taping Rule, regardless of whether Newport should ever seek to reenter the industry.

Newport cites *CapWest Securities, Inc.*, in which FINRA found that the Sanction Guidelines directing adjudicators to consider a suspension or expulsion were “inapplicable” to a respondent firm that was no longer in business.⁸⁹ But FINRA did not find that expelling such a firm would have been punitive or without a remedial purpose. FINRA declared only that the guidelines in that particular case were “inapplicable” without explaining why. Nowhere in

⁸⁶ *Order Granting Approval of Proposed Rule Change*, Exchange Act Release No. 39883, 1998 WL 181628, at *6 (April 17, 1998).

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Dept. of Enf’t v. CapWest Sec., Inc.*, FINRA Complaint No. 2007010158001, 2013 FINRA Discip. LEXIS 4, at *30–33 nn. 24, 28 (NAC Feb. 25, 2013) (imposing fine but stating that “[b]ecause CapWest is no longer in business and FINRA has cancelled the firm’s membership” the part of the Guidelines concerning firm expulsion for supervisory violations are “inapplicable here”), *aff’d*, Exchange Act Release No. 31340, 2014 WL 198188 (Jan. 17, 2014).

CapWest did FINRA suggest that expelling a firm that was out of business would be punitive. Indeed, FINRA has expelled another firm that already had its FINRA membership cancelled.⁹⁰

Although not discussed by the parties, we observe that this case is also unlike *Castle Securities Corp.*⁹¹ There, the Commission set aside a suspension because NASD had already expelled the applicant firm from membership. The Commission determined that adding a suspension to the existing expulsion did not further investor protection. Here, Newport had not been expelled previously. Its misconduct demonstrates that it poses a risk to investors. Expelling Newport thus protects investors from the firm resuming its business and from former Newport representatives restarting the firm under a different name.

b. Newport’s expulsion does not subject it to impermissibly disparate treatment.

Second, Newport argues that the FINRA hearing panel failed to identify any remedial purpose for expelling Newport and that, unlike the NAC’s stated rationale, the hearing panel “seems to have singled out Newport, a firm with only a few hundred employees and no significant disciplinary history at the time when it issued its decision.” But “it is the decision of the NAC, not the decision of the Hearing Panel, that is the final action of [FINRA] which is subject to Commission review.”⁹² The NAC articulated a remedial purpose for expelling Newport, and the firm had a significant disciplinary history at the time of the NAC’s decision.

In any case, Newport’s argument fails on the merits. To establish a claim of selective prosecution, an applicant must demonstrate that it was unfairly singled out for enforcement action when others who were similarly situated were not and that the applicant’s prosecution was motivated by improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right.⁹³ Here, there is no evidence substantiating Newport’s claim that FINRA unfairly singled out the firm for investigation or enforcement based on any of those grounds. Newport provides only broad, unsupported generalities about what it claims is the

⁹⁰ *Fox Fin. Mgmt.*, Complaint No. 2012030724101, 2017 FINRA Discip. LEXIS 3, at *1–2, *31–32 (Jan. 6, 2017) (expelling a firm, even though it was out of business, that had failed to record and supervise private securities transactions or establish and maintain a supervisory system and written supervisory procedures).

⁹¹ Exchange Act Release No. 52580, 2005 WL 2508169, at *5 (Oct. 11, 2005).

⁹² *Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 WL 3313843, at *6 n.17 (Nov. 8, 2006)).

⁹³ *See David Kristian Evansen*, Exchange Act Release No. 75531, 2015 WL 4518588, at *10 & n.54 (July 27, 2015) (denying applicant’s claim of selective prosecution and citing cases). We consider this claim in light of the Exchange Act’s general statutory requirement that self-regulatory organizations like FINRA provide a “fair procedure” for disciplining members. *Id.* at *6 nn.34–35, *10 n.54 (citing Exchange Act Section 15A(b)(8), 15 U.S.C. § 78o-3(b)(8)).

unequal prosecution of small and large firms. That is not an adequate basis for us to conclude that FINRA’s expulsion of the firm resulted in inappropriately disparate treatment.⁹⁴

Nor can Newport succeed under the Equal Protection Clause on a “class-of-one” theory, under which someone who is not a member of a protected class nonetheless may assert an equal protection claim by showing that he or “she has been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment.”⁹⁵ The Supreme Court held in *Engquist v. Oregon Department of Agriculture* that a class-of-one claim is not cognizable in the context of activities or decisions that “by their nature involve discretionary decisionmaking based on a vast array of subjective, individualized assessments.”⁹⁶ Because self-regulatory organization “disciplinary proceedings are treated as an exercise of prosecutorial discretion,”⁹⁷ and “*Engquist* precludes [class-of-one] challenges to prosecutors’ decisions about whom, how, and where to prosecute,”⁹⁸ Newport’s claim fails as a matter of law. Newport’s claim also fails because those asserting such a claim “must show an extremely high degree of similarity between themselves and the persons to whom they compare themselves”—something that Newport has not done.⁹⁹

Newport contends further that its expulsion is inappropriately disproportionate because “[t]he big firms, most of which have hundreds of disclosures, simply pay a fine no matter how egregious the conduct” and asks why, here, the two “direct line supervisors were only suspended but somehow an entire firm has to be expelled?” As discussed above, Newport does not identify a litigated proceeding involving a “big firm” that was found liable for excessive trading, churning, qualitatively unsuitable recommendations, and failures to supervise and that resulted in disproportionate sanctions to those at issue here. As for the two supervisors to whom Newport

⁹⁴ See *William J. Haberman*, Exchange Act Release No. 40673, 1998 WL 786945, at *4 (Nov. 12, 1998) (rejecting applicant’s claim of bias against small firms where he offered no supporting evidence); *First Colorado Fin. Servs. Co., Inc.*, Exchange Act Release No. 40436, 1998 WL 603229, at *6–7 (Sept. 14, 1998) (rejecting applicants’ claim of “unfair treatment of small firms” where applicants alleged no specific instances of bias or selective enforcement and provided no evidence to support their claims).

⁹⁵ *Vill. of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000).

⁹⁶ 553 U.S. 591, 603 (2008).

⁹⁷ *Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993).

⁹⁸ *Charles L. Hill, Jr.*, Exchange Act Release No. 79459, 2016 WL 7032731, at *2 & n.21 (Dec. 2, 2016) (citing *United States v. Green*, 654 F.3d 637, 650 (6th Cir. 2011) and *United States v. Moore*, 543 F.3d 891, 901 (7th Cir. 2008)).

⁹⁹ *Clubside, Inc. v. Valentin*, 468 F.3d 144, 159 (2d Cir. 2006); see also *Cordi-Allen v. Conlon*, 494 F.3d 245, 250–51 (1st Cir. 2007) (explaining that the requirement of establishing an “extremely high degree of similarity” also requires showing the absence of any “distinguishing or mitigating circumstances as would render the comparison inutile”).

compares its sanction, they settled their proceedings. We have observed repeatedly that “comparisons to sanctions in settled cases are inappropriate.”¹⁰⁰

c. The potential collateral consequences of Newport’s expulsion do not impose an undue burden on competition or make the sanction oppressive.

Third, Newport contends that its expulsion imposes an “undue burden on competition” because former associated persons of Newport (and member firms who hire them) “will be subject to the consequential effects” of that expulsion. Specifically, Newport claims that a number of its former representatives have associated with another member firm and that as a result of Newport’s expulsion the other firm will be required under the Taping Rule to record “all of its calls or fire half the Newport brokers and staff that it hired.”

The consequences of the Taping Rule do not constitute an undue burden on competition that requires us to set aside FINRA’s sanction. We have held that the Exchange Act’s requirement that an SRO’s sanctions not impose an undue burden on competition does not apply to “the economic impact on former securities professionals barred from further participation in the industry.”¹⁰¹ Rather, that provision of the Exchange Act seeks to enhance competition between securities exchanges and markets.¹⁰² Here, Newport alleges consequences only for associated persons and the firms that hire them. If a bar that prevents a respondent from obtaining a job does not constitute an undue burden on competition, as we have held it does not,¹⁰³ Newport’s expulsion does not constitute such a burden because the collateral consequences for the affected individuals are far more attenuated.

Newport also argues that its expulsion is “oppressive” because its former representatives will face “prejudice and distrust” from potential employers and customers who will be able to see that they were previously associated with an expelled firm on FINRA’s BrokerCheck website. FINRA maintains BrokerCheck “as part of its statutory obligation under Section 15A(i) of the Exchange Act to ‘establish and maintain a system for collecting and retaining registration information’ about registered broker-dealers and to make such information available to the

¹⁰⁰ *Scholander*, 2016 WL 1255596, at *11 (quoting *Kent M. Houston*, Exchange Act Release No. 71589, 2014 WL 651953, at *7 (Feb. 20, 2014)); *McCune*, 2016 WL 1039460, at *10 (same).

¹⁰¹ *Howard Brett Berger*, Exchange Act Release No. 58950, 2008 WL 4899010, at *13 (Nov. 14, 2008) (finding no undue burden on competition where applicant argued that “the ‘stigma’ of a bar would impede his ability to engage in lawful economic activity”).

¹⁰² The Securities Reform Act of 1975 (the “SRA”) added the requirement to Exchange Act Section 19 that an SRO’s sanctions not impose an unnecessary or inappropriate burden on competition. *See* Pub. L. No. 94-29, 89 Stat. 97 (codified as amended in scattered sections of Title 15 of the United States Code). The intent of the SRA, and thus of Section 19, is to “break down the unnecessary regulatory restrictions which . . . restrain competition among markets and market makers.” *Berger*, 2008 WL 4899010, at *13 n.73 (quoting S. Rep. No. 94-75, at 12–13).

¹⁰³ *See supra* note 1011.

public.¹⁰⁴ “Registration information” includes information about “disciplinary actions, regulatory, judicial, and arbitration proceedings.”¹⁰⁵ FINRA Rule 8312 governs the information that FINRA releases to the public through BrokerCheck, including information regarding current and former FINRA member firms and their current and former associated persons.¹⁰⁶ We have stated that making information available on BrokerCheck “will help members of the public to protect themselves from unscrupulous people” and “should help prevent fraudulent and manipulative acts and practices, and protect investors and the public interest.”¹⁰⁷ The fact that members of the public will be able to see that Newport was expelled and therefore that certain individuals were formerly associated with an expelled firm does not make the sanction “oppressive” as to Newport; rather, it provides the public with important information consistent with the Exchange Act’s requirement that it make registration information publicly available.

B. We sustain FINRA’s order imposing a fine on Newport.

We sustain FINRA’s imposition of a \$403,000 fine. That fine consists of \$220,000 for excessive trading and churning; \$110,000 for making unsuitable recommendations; and \$73,000 for failing reasonably to supervise. These amounts are consistent with the Guidelines.¹⁰⁸ As Newport does not challenge the fine, it identifies no pertinent mitigating factors. Nor does it dispute that the fine is remedial. Under the circumstances, we find the fine neither excessive nor oppressive.

C. We sustain FINRA’s order of restitution.

We sustain FINRA’s order of restitution. Restitution is appropriate “when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent’s misconduct.”¹⁰⁹ “An order requiring restitution . . . seeks primarily to return customers to their prior positions by restoring the funds of which they were wrongfully deprived.”¹¹⁰ FINRA ordered Newport to pay restitution (jointly and severally with Leone, La Barbera, and the Defaulting Respondents)

¹⁰⁴ *Eric David Wanger*, Exchange Act Release No. 79088, 2016 WL 5571629, at *2 (Sept. 30, 2016) (quoting 15 U.S.C. § 78o-3(i)(1)).

¹⁰⁵ 15 U.S.C. § 78o-3(i)(5).

¹⁰⁶ FINRA Rule 8312.

¹⁰⁷ *Order Approving a Proposed Rule Change Relating to Availability of Information Pursuant to FINRA Rule 8312*, 74 Fed. Reg. 61,193, 61,195 (Nov. 23, 2009).

¹⁰⁸ *See supra* notes 68–73 and accompanying text.

¹⁰⁹ Guidelines at 4 (General Principle No. 5) (stating that, “[w]here appropriate to remediate misconduct, Adjudicators should order restitution and/or rescission”).

¹¹⁰ *Kenneth C. Krull*, Exchange Act Release No. 40768, 1998 WL 849545, at *6 (Dec. 10, 1998); *see also United States v. Dubose*, 146 F.3d 1141, 1146 (9th Cir. 1998) (“[B]ecause the full amount of restitution is inherently linked to the culpability of the offender, restitution orders that require full compensation in the amount of the loss are not excessive.”).

totaling \$853,617.04, plus prejudgment interest.¹¹¹ This figure accounts for the commissions, markups, and markdowns that each customer paid because of Newport’s excessive trading in his or her account. Newport does not challenge the order of restitution. We find that the restitution order restores customers to the position they would have been in if they had not been subject to Newport’s misconduct and is therefore remedial and neither excessive nor oppressive.¹¹²

V. Constitutional and Procedural Arguments

Newport challenges these proceedings on constitutional and other procedural grounds. It argues that FINRA’s adjudicators—its hearing officers and the members of the National Adjudicatory Council—are “inferior officers of the United States” who were subject to the Appointments Clause of the U.S. Constitution. Newport also asserts that it was deprived of a “fair and impartial” hearing because of a purported lack of independence on the part of FINRA’s decision-makers. As explained below, these objections are forfeited because Newport failed to exhaust them before FINRA. In any event, Newport’s arguments lack merit.¹¹³

A. Newport’s Appointments Clause argument is forfeited and lacks merit.

Newport claims that the Supreme Court’s decision in *Lucia v. SEC*¹¹⁴ “makes clear that every officer with significant authority established by law”—which it argues includes FINRA adjudicators—“is an Officer of the United States, and thus subject to the Appointments Clause.” *Lucia* held that the Commission’s administrative law judges, who preside over hearings and issue initial decisions in administrative proceedings instituted by the Commission, are “inferior officers” of the United States who were not appointed in the manner the Appointments Clause required.¹¹⁵ Newport’s argument is not properly before us and, in any event, lacks merit.

¹¹¹ FINRA ordered that prejudgment interest would accrue as of May 31, 2013, which is the end of the relevant period in this case, until paid in full.

¹¹² *Cf. United States v. Newell*, 658 F.3d 1, 35 (1st Cir. 2011) (observing that “restitution is inherently proportional, insofar as the point of restitution is to restore the victim to the status quo ante”); *Ahmed*, 2017 WL 4335036, at *26 (affirming FINRA’s order of restitution to “redress[] the harm Respondents caused”). We further find that where, as here, there are multiple parties liable for misconduct, it was appropriate to impose that obligation on respondents jointly and severally. *See, e.g., Anderson v. Griffin*, 397 F.3d 515, 523 (7th Cir. 2005)

¹¹³ Although we address and reject Newport’s arguments on the merits, we find as an independent procedural matter that they are forfeited and thus not properly before the Commission. *See, e.g., BDPCS, Inc. v. FCC*, 351 F.3d 1177, 1183 (D.C. Cir. 2003) (rejecting contention that an agency’s “consideration of the merits . . . has the effect of abrogating the dismissal, on procedural grounds, of those same arguments”); *Bartholdi Cable Co. v. FCC*, 114 F.3d 274, 280 (D.C. Cir. 1997) (“discussion of an alternative [merits-related] ground for its decision did not undermine . . . ruling that . . . claim was untimely raised”).

¹¹⁴ 138 S. Ct. 2044 (2018).

¹¹⁵ *Id.* at 2049.

1. Newport failed to exhaust its Appointments Clause argument.

Newport failed to exhaust its claim that the manner of selection of FINRA’s adjudicators violates the Appointments Clause by failing to raise the claim before FINRA. As the Second Circuit has held in the context of Commission review of an SRO action, imposing an exhaustion requirement “promotes the efficient resolution of disciplinary disputes between SROs and their members and is in harmony with Congress’s delegation of authority to SROs to settle, in the first instance, disputes relating to their operations.”¹¹⁶ “Were SRO members . . . free to bring their SRO-related grievances before the SEC without first exhausting SRO remedies, the self-regulatory function of SROs could be compromised.”¹¹⁷ It is therefore “clearly proper to require that a statutory right to review be exercised in an orderly fashion, and to specify procedural steps which must be observed as a condition to securing review.”¹¹⁸ “Proper exhaustion” of administrative remedies demands “compliance with an agency’s deadlines and other critical procedural rules” governing the presentation of arguments and “objection[s] at the time appropriate under its practice” because “no adjudicative system can function effectively without imposing some orderly structure on the course of its proceedings.”¹¹⁹

Here, the record establishes that Newport failed to raise its Appointments Clause argument at any point before FINRA. It did not mention the issue before the hearing panel, in its notice of appeal or briefs to the NAC, or at oral argument before the NAC.¹²⁰ Indeed, as noted above, Newport expressly limited its arguments before the NAC to the “sole issue” of whether

¹¹⁶ *MFS Sec. Corp. v. SEC*, 380 F.3d 611, 622 (2d Cir. 2004).

¹¹⁷ *Id.* at 621; *see also id.* (finding “valid” the Commission’s routine application of “an exhaustion requirement in its review of disciplinary actions by SROs”).

¹¹⁸ *See, e.g., Behnam Halali*, Exchange Act Release No. 79722, 2017 WL 24498, at *3 (Jan. 3, 2017); *Li-Lin Hsu*, Exchange Act Release No. 78899, 2016 WL 5219504, at *2 (Sept. 21, 2016).

¹¹⁹ *Woodford v. Ngo*, 548 U.S. 81, 90-91 (2006); *see also McBarron Capital LLC*, Exchange Act Release No. 81789, 2017 WL 4350655, at *5 & n.31 (Sep. 29, 2017).

¹²⁰ *See* FINRA Rule 9215(b) (“Any affirmative defense shall be asserted in the answer.”); FINRA Rule 9311(e) (“The National Adjudicatory Council may, in its discretion, deem waived any issue not raised in the notice of appeal . . .”); FINRA Rule 9347(a) (“An exception to findings, conclusions, or sanctions shall be supported by citation to the relevant portions of the record . . . and by concise argument, including citation of such statutes, decisions, and other authorities as may be relevant.”). The NAC does have the authority to *sua sponte* address issues not raised by the parties, FINRA Rule 9311(e); *Nicholas S. Savva*, Exchange Act Release No. 72485, 2014 WL 2887272, at *13 n.70 (Feb. 29, 2016), but it is not required to exercise this authority in any particular case so as to overlook a party’s waiver or forfeiture, and it did not do so here. *See, e.g., Guzzo v. Cristofano*, 719 F.3d 100, 112 (2d Cir. 2013); *Tamenut v. Mukasey*, 521 F.3d 1000, 1005 (8th Cir. 2008) (en banc); *ABN AMRO Clearing Chicago LLC*, Exchange Act Release No. 83849, 2018 WL 3869452, at *12 n.106 (Aug. 16, 2018); *Bennett Grp. Fin. Servs., LLC*, Exchange Act Release No. 80347, 2017 WL 1176053, at *2 n.7 (Mar. 30, 2017).

“the penalty exerted against Newport Capital” was “excessive.”¹²¹ Newport’s failure to raise its Appointments Clause argument before FINRA is reason enough for us to reject it now.¹²²

Newport contends that it was not required to raise this claim earlier because, in its view, it did not become available until *Lucia* was decided in June 2018 and that was after the NAC had issued its decision. But Newport’s unawareness of the availability of the claim does not excuse the failure to exhaust it, even assuming for “sake of argument . . . that an intervening change in the law might constitute a reasonable ground to excuse the failure to exhaust.”¹²³ “No precedent prevented the company from bringing the constitutional claim before then,” because “*Lucia* itself noted that existing case law ‘says everything necessary to decide this case,’” and because courts even “before *Lucia*[] held that administrative law judges were inferior officers” and “many other litigants pressed the issue before *Lucia*.”¹²⁴ The decision in *Lucia* “merely applied the Supreme Court’s 1991 opinion in *Freytag v. Commissioner of Internal Revenue*,”¹²⁵ and Newport could have done the same before FINRA.¹²⁶ Thus, we see no basis to excuse Newport’s failure to exhaust based on the alleged novelty of the claim.

¹²¹ Newport now asserts, without citation to the record, that it “raised the issue[] . . . during its appeal to the NAC.” Our review of the relevant briefs and transcripts shows that this assertion is false.

¹²² See, e.g., *Laurie Jones Canady*, Exchange Act Release No. 41250, 1999 WL 183600, at *12 (Apr. 5, 1999), *aff’d*, 230 F.3d 362, 362-63 (D.C. Cir. 2000) (upholding Commission’s conclusion that respondent “waived [a] defense by failing to argue it”); *Stephen Russell Boadt*, Exchange Act Release No. 32095, 1993 WL 365355, at *2 (Sept. 15, 1993) (“We are therefore not required to consider this objection because he failed to present it to the District Committee . . .”); see also *FEC v. Legi-Tech*, 75 F.3d 704, 707 (D.C. Cir. 1996) (stating that the “assertion that the FEC is unconstitutionally composed cannot be regarded as anything other than an affirmative defense,” which “must be raised in the pleading”).

¹²³ *Malouf v. SEC*, 933 F.3d 1248, 1257 (10th Cir. 2019) (declining to excuse the petitioner’s failure to “administratively exhaust his challenge under the Appointments Clause”).

¹²⁴ *Island Creek Coal Co. v. Wilkerson*, 910 F.3d 254, 257 (6th Cir. 2018) (concluding that the party “forfeited this Appointments Clause challenge” and “see[ing] no reasoned basis for forgiving the forfeiture” based on the alleged unavailability of the claim prior to *Lucia*) (citing *Bandimere v. SEC*, 844 F.3d 1168, 1188 (10th Cir. 2016)); see also *Meanes v. Johnson*, 138 F.3d 1007, 1011 (5th Cir. 1998) (“We note that a claim is not novel if other defense counsel have perceived and litigated that claim.”) (quotation marks omitted).

¹²⁵ *Bandimere*, 933 F.3d at 1258 (citing 501 U.S. 868 (1991)); see also *Pharmacy Doctors Enters., Inc. v. DEA*, 786 F. App’x 724, 729 (11th Cir. 2019) (“The availability of [the Appointments Clause challenge] does not depend on whether a court has already issued a decision addressing that exact argument.”).

¹²⁶ Newport claims not that raising the issue would have been futile but only that the law was “unsettled” prior to *Lucia*. See *Bandimere*, 933 F.3d at 1256–57 (rejecting futility argument).

We also reject Newport’s argument that the “fundamental” nature of its Appointments Clause claim and the need to avoid a “gross miscarriage of justice” compel us to excuse its failure to raise the issue earlier. Appointments Clause challenges are “not jurisdictional and thus are subject to ordinary principles of waiver and forfeiture.”¹²⁷ In *Freytag*, for example, although the Supreme Court chose to “exercise [its] discretion” to consider an Appointments Clause challenge that had not been raised in the court below,¹²⁸ it characterized the challenge as “nonjurisdictional” and did not hold that courts or agencies must hear untimely challenges.¹²⁹

The Supreme Court “has never indicated that [Appointments Clause] challenges must be heard regardless of waiver.”¹³⁰ Rather, it has stated that such challenges *may* be considered despite forfeiture or waiver only in “rare cases.”¹³¹ For that reason, appellate courts “have not read *Freytag*’s exception broadly and have regularly declined to consider unexhausted Appointments Clause challenges like the challenges here.”¹³² In our view, this is not one of those rare cases in which we should exercise our discretion to excuse Newport’s prior forfeiture.

¹²⁷ *Wilkerson*, 910 F.3d at 256 (quotation marks omitted); *see also United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 38 (1952) (“[T]he [statutory] defect in the examiner’s appointment . . . is not one which deprives the Commission of power or jurisdiction, so that even in the absence of timely objection its order should be set aside as a nullity.”).

¹²⁸ 501 U.S. at 879.

¹²⁹ *Id.*; *see also id.* at 893–94 (Scalia, J., concurring in part and concurring in the judgment) (“Appointments Clause claims, and other structural constitutional claims, have no special entitlement to review. A party forfeits the right to advance on appeal a nonjurisdictional claim, structural or otherwise, that he fails to raise at trial.”); *United States v. Olano*, 507 U.S. 725, 731 (1993) (“No procedural principle is more familiar . . . than that a constitutional right, or a right of any other sort, may be forfeited . . . by the failure to make timely assertion of the right.”).

¹³⁰ *In re DBC*, 545 F.3d 1373, 1380 (Fed. Cir. 2008).

¹³¹ *Freytag*, 501 U.S. at 879 (emphasis added).

¹³² *Island Creek Coal Co. v. Bryan*, 937 F.3d 738, 754 (6th Cir. Sept. 11, 2019) (collecting cases); *Malouf*, 933 F.3d at 1258; *Kabini & Co. v. SEC*, 733 F. App’x 918, 919 (9th Cir. 2018); *see also D.R. Horton, Inc. v. NLRB*, 737 F.3d 344, 351 n.5 (5th Cir. 2013) (declining to consider unexhausted claim notwithstanding alleged novelty of it because “all the legal arguments raised in that case were available to [the party] from the outset”); *Intercollegiate Broad. Sys. v. Copyright Royalty Bd.*, 574 F.3d 748, 755–56 (D.C. Cir. 2009) (holding that court “need not resolve” Appointments Clause challenge raised after the close of briefing).

Our conclusion here is consistent with prior decisions in which we have declined to consider untimely or otherwise improperly raised Appointments Clause claims.¹³³

2. Newport’s Appointments Clause argument fails on the merits.

In any event, and aside from our holding that it has been forfeited, we reject Newport’s Appointments Clause claim on the merits. The Appointments Clause requires that inferior officers of the United States be appointed by one of “three sources: ‘the President alone,’ ‘the Heads of Departments,’ and ‘the Courts of Law.’”¹³⁴ Newport contends that FINRA hearing officers and NAC members were not appointed in a manner consistent with the Appointments Clause. It notes that FINRA’s adjudicators perform many of the same functions as the Commission’s ALJs, whom the Supreme Court determined in *Lucia* qualified as inferior Officers of the United States. Yet, Newport observes, they “were appointed by” other FINRA staff members, not the President, a head of department, or a court.

Newport’s argument fails because, as we have held previously, the Appointments Clause does not apply to FINRA; accordingly, the manner in which FINRA hires its staff, hearing officers, and NAC members cannot violate the Appointments Clause.¹³⁵ There is a difference of constitutional import, the Supreme Court has recognized, between “Government-created, Government-appointed entit[ies],” on the one hand, and “[t]he self-regulatory organizations” (SROs) like FINRA, which are not government-created, on the other.¹³⁶ Because FINRA is not

¹³³ See, e.g., *Brett Thomas Graham*, Exchange Act Release No. 84106, 2018 WL 4348490, at *10 (Sep. 12, 2018); *Gordon Brent Pierce*, Exchange Act Release No. 77643, 2016 WL 1566396, at *2 (Apr. 18, 2016), *petition for review dismissed*, No. 16-1185 (D.C. Cir. Nov. 7, 2016) (per curiam); *Manuel P. Asensio*, Exchange Act Release No. 62315, 2010 WL 2468111, at *8 (June 17, 2010), *reconsideration denied*, Exchange Act Release No. 62645, 2010 WL 3043628, at *2 (Aug. 4, 2010), *aff’d*, 447 F. App’x 984, 986 n.1 (11th Cir. 2011). Moreover, the decision whether to overlook a waiver or forfeiture is inherently discretionary, so “the fact that in another situation the Commission once decided not to insist on observing the exhaustion requirement does not compel the conclusion that it was required not to impose it here.” *MFS Sec. Corp.*, 380 F.3d at 623; *accord In re Avid Identification Sys., Inc.*, 504 F. App’x 885, 890 (Fed. Cir. 2013) (“[T]hat the Board has on occasion overlooked particular procedural defaults does not mean that it is compelled to waive those procedural requirements for all subsequent cases.”); *NLRB v. Izzzi*, 343 F.2d 753, 755 (1st Cir. 1965) (“Nor, we might observe, will justice for individual litigants having good excuses be further[ed] generally if the Board must anticipate that . . . every grant of grace in a particular case will put it on the defensive whenever some new applicant for grace is disappointed.”).

¹³⁴ *Freytag*, 501 U.S. at 878 (quoting U.S. Const. Art. II, § 2, cl. 2).

¹³⁵ See *Asensio*, 2010 WL 2468111, at *8 (stating “[c]onstitutionally protected appointments . . . are those that are ‘conferred by the appointment of a government’”) (citation omitted).

¹³⁶ *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 485 (2010).

“part of the Government itself” for constitutional purposes,¹³⁷ FINRA’s employees cannot be “officers of the United States” for purposes of the Appointments Clause.

The Appointments Clause applies only when Congress creates an office of the United States—a continuing federal position, “established by Law,”¹³⁸ that exercises “significant authority pursuant to the laws of the United States.”¹³⁹ But the Appointments Clause says nothing about how individuals who do *not* occupy a position established by Congress and who do *not* exercise significant authority “pursuant to the laws of the United States” must be selected. For example, a municipal official who does not act under color of federal law or an arbitrator who derives authority from contractual consent could not qualify as an “officer of the United States.”¹⁴⁰ The same is true of FINRA adjudicators, and therefore they, like others who do not “hold an office under the government . . . established under the Constitution,”¹⁴¹ need not be appointed pursuant to the Appointments Clause. Decades of judicial decisions considering the role of self-regulatory associations like FINRA within the securities industry confirm that FINRA is “a private organization, not an arm of the government.”¹⁴² FINRA is a private entity:

¹³⁷ See *id.* at 486 (noting parties’ agreement that the Public Company Accounting Oversight Board was “‘part of the Government’ for constitutional purposes,” and so subject to the Appointments Clause) (quoting *Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374, 397 (1995)); *cf.* *Lebron*, 513 U.S. at 397 (holding that Amtrak was part of the Government because it is a “Government-created and -controlled corporation[] . . . established and organized under federal law” and “under the direction and control of federal governmental appointees”).

¹³⁸ *Freytag*, 501 U.S. at 881 (observing that the “office” of the special tax judge was “established by Law” and that its “duties, salary, and means of appointment . . . [were] specified by statute”); *United States v. Hartwell*, 73 U.S. 385, 393 (1867) (“An office is a *public* station, or employment, conferred by the appointment of *government*.”) (emphasis added).

¹³⁹ *Buckley v. Valeo*, 424 U.S. 1, 126 (1976) (per curiam).

¹⁴⁰ See, e.g., *Corr v. Metro. Washington Airports Auth.*, 800 F. Supp. 2d 743, 758 (E.D. Va. 2011) (“Appointments Clause does not apply to state members of an interstate entity”), *aff’d*, 740 F.3d 295 (4th Cir. 2014); *Tenaska Washington Partners II, L.P. v. U.S.*, 34 Fed. Cl. 434, 440 (Fed. Cl. 1995) (arbitrators not subject to Appointments Clause); *Seattle Master Builders Ass’n v. P. N.W. Elec. Power & Conservation Plan. Council*, 786 F.2d 1359, 1365 (9th Cir. 1986) (rejecting Appointments Clause challenge where “the states ultimately empower the Council members to carry out their duties”); *Parcell v. Kansas*, 468 F. Supp. 1274, 1277 (D. Kan. 1979) (“Clearly, the clause does not affect appointments of state officials.”); *Cooper v. Berger*, 822 S.E.2d 286, 293 & n.4 (N.C. 2018) (“Our state constitution’s appointment model thus differs from the federal appointment model.”); see also *Hartwell*, 73 U.S. at 393 (“A government office is different from a government contract.”); *United States v. Maurice*, 26 F. Cas. 1211, 1214 (C.C. Va. 1823) (Marshall, J.) (“A man may certainly be employed under a contract, express or implied, to do an act, or perform a service, without becoming an officer.”).

¹⁴¹ *United States v. Germaine*, 99 U.S. 508, 510 (1879).

¹⁴² See, e.g., *Ford v. Hamilton Inves., Inc.*, 29 F.3d 255, 259 (5th Cir. 1994) (discussing FINRA’s predecessor, the National Association of Securities Dealers, or “NASD”).

It operates as a private, Delaware non-profit corporation;¹⁴³ it receives no funding from any government;¹⁴⁴ and the positions within it are not created by federal law.

Newport correctly concedes that “earlier courts have concluded that” the SROs are not part of the government. Nevertheless, it argues for the first time in its reply brief that the Supreme Court in *Brentwood Academy v. Tennessee Secondary School Athletic Association*, 531 U.S. 288 (2001), “opened the door to a judicial reclassification” of FINRA’s status. This argument is waived.¹⁴⁵ Regardless, *Brentwood* involved the question of whether an entity engaged in “state action” such that it could be sued under 42 U.S.C. § 1983; it said nothing about the Appointments Clause or who should be considered to be an “officer of the United States” for purposes of that clause. In any case, we have previously considered *Brentwood*’s import and specifically rejected the contention that it “overturns the well-settled case law” holding that SROs like FINRA are not “state actor[s].”¹⁴⁶ Also for the first time in its reply brief, Newport asserts that FINRA is a state actor because it is “doing the same thing as the Commission, regulating the securities industry.” Again, this argument is waived.¹⁴⁷ And in any event, the test for whether an entity is a state actor is *not* “whether, in [the SRO’s] absence, the government would need to take over the role of regulator of [the SRO’s] member companies.”¹⁴⁸

¹⁴³ See *Order Adopting Proposed Rule Change Relating to the Restated Certificate of Incorporation of Financial Industry Regulatory Authority, Inc.*, File No. SR-FINRA-2010-027, Exchange Act Release No. 62441, 2010 WL 2712866 (July 2, 2010).

¹⁴⁴ *Graman v. Nat’l Ass’n of Sec. Dealers, Inc.*, 1998 WL 294022, *2 (D.D.C. Apr. 27, 1998) (regarding FINRA’s predecessor, the National Association of Securities Dealers); accord *D.L. Cromwell Inves., Inc. v. NASD Reg., Inc.*, 279 F.3d 155, 162 (2d Cir. 2002).

¹⁴⁵ See Rule of Practice 420(c), 17 C.F.R. § 201.420(c) (“Any exception to a determination not supported in an opening brief . . . may . . . be deemed to have been waived”); *Timothy S. Dembski*, Exchange Act Release No. 80306, 2017 WL 1103685, at *8 (Mar. 24, 2017) (“Arguments first developed in a reply brief are generally deemed waived.”), *petition denied*, 726 F. App’x 841 (2d Cir. 2018); *Fields*, 2015 WL 728005, at *19 & n.115 (explaining that “arguments for reversal not made in the opening brief” are subject to waiver).

¹⁴⁶ *Charles C. Fawcett, IV*, Exchange Act Release No. 56770, 2007 WL 3306105, at *4 (Nov. 8, 2007); accord *Santos-Buch v. FINRA*, 32 F. Supp. 3d 475, 484 (S.D.N.Y. 2014) (finding *Brentwood* inapposite to NASD because it “receives no federal funding, is a private corporation, and its Board of Governors and Board of Directors are not required to be government officials or appointed by government officials”), *aff’d*, 591 F. App’x 32 (2d Cir. 2015).

¹⁴⁷ See *supra* note 145.

¹⁴⁸ *Perpetual Sec., Inc. v. Tang*, 290 F.3d 132, 138 (2d Cir. 2002); see also *Marchiano v. NASD*, 134 F. Supp. 2d 90, 95 (D.D.C. 2001) (rejecting argument that FINRA’s “regulatory responsibilities” made FINRA a state actor).

In short, FINRA is not part of the United States government; as such, the hiring of its employees, FINRA adjudicators included, is not subject to the Appointments Clause's requirements.

B. Newport's bias argument is forfeited and meritless.

Newport also asserts that it was “denied its due process right” to a “fair and impartial” hearing because FINRA’s Department of Enforcement ostensibly “control[s] every aspect of the process from initiating charges to the NAC Decision.” Like its Appointments Clause argument, Newport’s bias claim is forfeited because Newport did not raise the issue before the hearing panel or before the NAC and therefore did not exhaust the issue before FINRA. “Under FINRA Rule 9233, a party seeking to disqualify a Hearing Officer on grounds of alleged bias must move for disqualification within fifteen days of learning the facts that are the grounds for disqualification.”¹⁴⁹ FINRA Rule 9332 provides similarly that motions seeking to disqualify a NAC member must be filed “not later than 15 days” from discovery of the facts that are the alleged grounds for disqualification.¹⁵⁰ By not seeking disqualification under either rule, Newport forfeited its bias objection.¹⁵¹ And more generally, by failing to present that objection to FINRA in *any* manner, Newport failed to exhaust its administrative remedies before FINRA, which is a sufficient reason for us to reject the bias claim now.

In any case, we find no merit in Newport’s unsubstantiated and generalized assertions of bias. Newport contends that a “conflict of interest . . . exists between FINRA Enforcement” and the hearing officers or NAC panelists resulting in a purported lack of “independence” between FINRA Enforcement and the “other FINRA staff who decide” disciplinary actions. But “FINRA rules ensur[e] separation of functions in FINRA disciplinary proceedings.”¹⁵² As a result, we have rejected claims that it is “unfair for FINRA to act as ‘the judge, the prosecutor and the jury’” where “there is no evidence that those rules were not followed.”¹⁵³ Here, the record shows that FINRA Enforcement did not exert improper influence at any stage of proceedings. Shortly after FINRA Enforcement filed its complaint, the Deputy Chief Hearing Officer appointed a

¹⁴⁹ *Merrimac Corp. Sec.*, 2019 WL 3216542, at *25 (citing FINRA Rule 9233(b)).

¹⁵⁰ FINRA Rule 9332.

¹⁵¹ *Id.*; *see also Ahmed*, 2017 WL 4335036, at *22 (finding that applicant who failed to “object to the Panelist’s participation on the Hearing Panel” waived his bias challenge); *Kenny Akindemowo*, Exchange Act Release No. 79007, 2016 WL 5571625, at *10 n.35 (Sept. 30, 2016) (finding that applicant had an “opportunity to object to the hearing panel members under FINRA rules but did not do so”).

¹⁵² *Akindemowo*, 2016 WL 5571625, at *10; *see also Sheldon v. SEC*, 45 F.3d 1515, 1518–19 (11th Cir. 1995) (explaining that “it is uniformly accepted that many agencies properly combine the functions of prosecutor, judge and jury” within the agency and that an agency does not “improperly act[] as both an enforcer and arbiter” simply because its “employees gathered and presented the evidence” with the hearing held before another employee).

¹⁵³ *Akindemowo*, 2016 WL 5571625, at *10.

hearing officer (and later a replacement);¹⁵⁴ the Chief Hearing Officer then appointed the two other panelists from the industry. Subsequently, the NAC subcommittee empaneled to hear Newport’s appeal was drawn from the full NAC’s fifteen members, none of whom are FINRA employees. As we have stated before, “it is the NAC, not the staff, that makes decisions,” and even if a member of FINRA’s staff were “biased, that would not mean that the [NAC] is biased.”¹⁵⁵ We find no evidence that FINRA Enforcement compromised the independence of the hearing panel or the NAC, or that either body was biased or prejudiced against Newport.

* * *

¹⁵⁴ Although FINRA employs and pays the hearing officers, the “structure of [organizational] employment” is not a reason to conclude that hearing officers are actually biased. *See Harlin v. DEA*, 148 F.3d 1199, 1204 (10th Cir. 1998) (discussing administrative law judges, who are typically appointed by the agency that uses them) (citing *Withrow v. Larkin*, 421 U.S. 35 (1975), *Butz v. Economou*, 438 U.S. 478 (1978), and *Ramspeck v. Fed. Trial Examiners Conference*, 345 U.S. 128 (1953)). Indeed, FINRA’s rules protect hearing officers’ decisional independence: “The Office of Hearing Officers maintains strict independence from FINRA’s regulatory programs and is physically separated from other FINRA departments. Hearing Officers are not involved in the investigative process. Employment protections exist for Hearing Officers to ensure their independence; they may not be terminated except by the FINRA Chief Executive Officer, with a right to appeal to the Audit Committee of FINRA’s Board of Governors.” *See* Office of Hearing Officers, <https://www.finra.org/rules-guidance/adjudication-decisions/office-hearing-officers-oho> (last visited April 1, 2020).

¹⁵⁵ *Bruce Zipper*, Exchange Act Release No. 84334, 2018 WL 4727001, at *9 (Oct. 1, 2018). Newport asserts that “FINRA respondents for years have faced long odds on appeals to the NAC.” However, neither adverse rulings in a particular case, *see AutoChina Int’l Ltd.*, Exchange Act Release No. 79010, 2016 WL 5571626, at *10 n.21 (Sept. 30, 2016) (citing *Liteky v. United States*, 510 U.S. 540, 555 (1994), and *Marcus v. Dir., Office of Workers’ Comp. Programs*, 548 F.2d 1044, 1051 (D.C. Cir. 1976)), nor alleged statistical trends across cases, *see S. Pac. Comm’n Co. v. AT&T*, 740 F.2d 980, 995 (D.C. Cir. 1984); *In re IBM*, 618 F.2d 923, 930 (2d Cir. 1980), by themselves support an inference of disqualifying judicial bias. Particularly given Newport’s failure to raise the bias issue before FINRA—and its consequent failure to take advantage of the opportunity to develop any relevant facts—we conclude that Newport has not and cannot meet its burden of establishing bias or prejudice. *Schweiker v. McClure*, 456 U.S. 188, 195 (1982); *Withrow*, 421 U.S. at 47.

For these reasons, we sustain FINRA's findings of violations and imposition of sanctions.

An appropriate order will issue.¹⁵⁶

By the Commission (Chairman CLAYTON and Commissioners PEIRCE, ROISMAN, and LEE).

Vanessa A. Countryman
Secretary

¹⁵⁶ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 88548 / April 3, 2020

Admin. Proc. File No. 3-18555

In the Matter of the Application of
NEWPORT COAST SECURITIES, INC.
For Review of Disciplinary Action Taken by
FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by FINRA against Newport Coast Securities, Inc. is sustained.

By the Commission.

Vanessa A. Countryman
Secretary