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UNITED STATES OF AMERICA
Before The
SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of

WEDBUSH SECURITIES, INC. and EDWARD WILLIAM WEDBUSH

For Review of Disciplinary Action Taken by FINRA

OPENING BRIEF OF APPLICANTS WEDBUSH SECURITIES INC. AND EDWARD WILILAM WEDBUSH

Admin. Proc. File No. 3-16329

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Pursuant to the February 24, 2015 Order Scheduling Briefs in this matter, Applicants Wedbush Securities Inc. ("WS") and Edward William Wedbush ("Mr. Wedbush") (collectively, "Applicants") submit the following Opening Brief in support of their application for review by the Commission of a final disciplinary action by FINRA.

1. Introduction

This appeal involves a determination of the National Adjudicatory Council of FINRA (the "NAC"). In a decision dated December 11, 2014 (the "NAC Decision"), the NAC not only upheld, but increased, the sanctions imposed on Applicants in a decision of the FINRA Office of Hearing Officers (the "OHO Decision"). The NAC Decision represents the final disciplinary decision of FINRA.

The NAC Decision is fatally flawed in numerous respects, many of which are detailed below. However, at a fundamental level, the NAC Decision rests in large part on the NAC's absurd conclusion that no distinction exists between a fine and a suspension. That such a conclusion is false is a matter of both fact and of law. Moreover, the obvious falsity of that conclusion undermines the entire NAC decision. Applicants' primary contention in their appeal of the OHO Decision to the NAC was that Mr. Wedbush had not been provided fair notice in connection with the underlying hearing panel's imposition of a 31-day suspension on him. The basis for that contention was that neither the FINRA Department of Enforcement ("Enforcement," or the "DOE"), nor the Hearing Panel, ever raised or even mentioned the possibility that the Panel would consider suspending Mr. Wedbush until that Panel issued the OHO Decision. As a result, Mr. Wedbush was denied a reasonable opportunity of even being heard on the issue of suspension. Moreover, having had no reason to believe that suspension was a possibility, Applicants were prevented from presenting evidence that would have established that no suspension is warranted.

The NAC Decision effectively dismisses that argument by concluding that a suspension and a fine constitute the same form of punishment. In fact, the NAC increased the suspension for Mr. Wedbush, despite the fact that the first reasonable notice provided to Mr.

Wedbush that he might be suspended was the underlying hearing panel's issuance of that suspension.

Although this violation of the most fundamental right—the right to a fair hearing—is alone sufficient to require reversal, the NAC Decision also should be reversed because the findings and sanctions issued by the NAC are not supported by the facts or the law, and in many cases rest on factually incorrect conclusions. Specifically, Applicants take exception to the following findings and conclusions:

1. Applicants take exception to the conclusion that they received a fair hearing;
2. Applicants take exception to the conclusion that Mr. Wedbush had responsibility for the regulatory filings at issue;
3. Applicants take exception to the conclusion that the adequacy of the firm's supervisory system was not at issue in this case.
4. Applicants take exception to the finding that the Business Conduct Department's personnel were not qualified to carry out their compliance and reporting obligations.
5. Applicants take exception to the finding that Applicants' measures to improve regulatory reporting were ineffective.

For these reasons, as set forth more fully below, Applicants respectfully submit that the Commission should reverse the sanctions issued against Applicant Edward Wedbush, and eliminate or reduce the sanctions issued against Applicant WS. In the alternative, Applicants submit that the Commission should vacate the Decision and remand this proceeding for a new hearing before a different FINRA Office of Hearing Officers panel.

2. Statement of Facts and Procedural History

This case concerns the timeliness of certain regulatory filings made by Applicant WS, and the supervision of such filings by both WS and Mr. Wedbush. Specifically, the case involves what are known as FINRA "Form U4" filings, "Form U5" filings, New York Stock Exchange RE-3 form filings, and FINRA Form 3070 filings. Industry-wide, broker-dealers file U4

and U5 forms late approximately 20-25% of the time[1]. FINRA alleged that WS's late filing percentage was unacceptably high, and that the supervision of those filings by Applicants was not reasonable.

FINRA initiated this matter by providing a verbal "Wells" notice to Applicant WS on December 16, 2008, followed by a written confirmation on December 17.[2] The Wells notice did not indicate that FINRA contemplated bringing any disciplinary action against firm President Edward Wedbush.[3] Applicant WS submitted a response to the original Wells notice on December 30, 2008.[4]

Eighteen months later, on June 18, 2010, FINRA issued a second Wells notice to Applicant WS, indicating that it had made a preliminary determination to recommend disciplinary action against WS related to untimely filings.[5] FINRA also indicated that it intended to recommend disciplinary action against Mr. Wedbush for an alleged failure to supervise WS's regulatory filings.[6]

Enforcement commenced the underlying disciplinary proceeding on October 4, 2010, by filing a disciplinary complaint.[7] The complaint contained four causes of action against Applicant WS, and one cause of action against Mr. Wedbush.[8] By way of relief, Enforcement requested an order imposing "one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions."[9] The complaint did not specifically request any suspension of Mr. Wedbush.[10]

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[1] FINRA does not keep statistics on the timeliness of RE-3 and 3070 filings, or at least elects not to publish them. The Form U4 and Form U5 filings at issue comprised a large percentage of the filings at issue.
[2] Enforcement Exhibit CX-161; Certification of the Record to the Securities and Exchange Commission, filed January 23, 2015 (hereinafter "Record"), Bates No. 005463.
[3] *Id.*
[4] CX-162; Record, Bates No. 005465.
[5] CX-142; Record, Bates No. 005305.
[6] *Id.*
[7] Record, Bates No. 0000001.
[8] *Id.*
[9] *Id.*, p. 25 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to Applicants).
[10] *Id.*, pp. 25-26.

Attached to the complaint was a chart listing the alleged reporting violations.[11] The chart listed 91 "Items," and 179 alleged reporting violations.[12] Applicants filed an answer to the complaint on December 8, 2010.[13]

On January 4, 2011, Enforcement filed a motion to amend the complaint.[14] The purpose of amending the complaint was to remove all references in the complaint to a February 18, 2009 Cautionary Action Letter.[15] Those references were removed because that Cautionary Action Letter had been withdrawn after the filing of the original complaint. (In other words, Enforcement was forced to acknowledge that the Letter of Caution issued to Wedbush should not have been issued.) Enforcement's motion to amend the complaint was granted, and Enforcement's Amended Complaint was filed as of January 11, 2011.[16] Like the original complaint, the Amended Complaint sought "one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions," but did not request any suspension of any individual.[17]

Eric Segall was counsel for Applicants from the outset of the case.[18] On February 9, 2011, Enforcement filed a motion to disqualify Mr. Segall.[19] That motion was denied.[20] Enforcement renewed that motion on May 3, 2011.[21] The renewed motion was granted on May 26, 2011.[22]

Enforcement filed a motion to amend the complaint a second time, on June 2, 2011.[23] The DOE claimed in its motion that Applicants would "not suffer any unfair prejudice [if the amendment were permitted] due to the promptness of the amendment and the early stage of the

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[11] *Id.*, Enforcement's chart (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to Applicants).
[12] *Id.*
[13] Record, Bates No. 000111.
[14] Record, Bates No. 000147.
[15] *Id.*
[16] Record, Bates No. 00251; Bates No. 00253.
[17] Record, Bates No. 00253, *et seq.*
[18] *See, e.g.*, Record, Bates No. 000101.
[19] Record, Bates No. 000325.
[20] Record, Bates No. 000495.
[21] Record, Bates No. 000523.
[22] Record, Bates No. 000675.
[23] Record, Bates No. 000679.

proceedings."[24] That motion was granted on June 16, 2011.[25] The Second Amended Complaint reduced the number of "Items" at issue from 91 to 81, and reduced the number of alleged reporting violations from 179 to 160.[26] As with the previous two versions of the complaint, the Second Amended Complaint contained four causes of action against Applicant WS, and one cause of action against Mr. Wedbush, and like the two prior versions, it did not request or otherwise notify the Applicants that Enforcement sought any suspension for any person or entity.[27]

The parties filed pre-hearing briefs on June 17, 2011.[28] As the issue had never been raised in writing or during any pre-hearing conference in this case, Applicants' brief did not address the possibility of a suspension for Mr. Wedbush.[29]

In its pre-hearing brief, Enforcement requested sanctions consisting of a $250,000 fine against the firm, and a censure and a $50,000 fine against Mr. Wedbush. Enforcement did not request, or even suggest, that Mr. Wedbush should be suspended, in any capacity, for any length of time. On the contrary, Enforcement noted in its brief that the FINRA Sanctions Guidelines "recommend a fine of $5,000 to $50,000 for an individual supervisor's failure to supervise," and suggested that a "censure and a fine at or above $50,000" was appropriate in this case.[30]

Along with their pre-hearing brief, Applicants submitted a witness list on June 17, 2011.[31] The witness list identified 23 witnesses that Applicants intended to call.[32] On July 1, 2011, Enforcement filed a Motion to Preclude Testimony of Certain Witnesses.[33] Specifically, the DOE sought to preclude the testimony of thirteen witnesses who had been designated to testify on the subjects of "the Firm's reporting structure and supervision" and Mr. Wedbush's "work ethic

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[24] Enforcement's Motion to Amend the Amended Complaint, p. 2; Record, Bates No. 000679.
[25] Record, Bates No. 000757.
[26] *See* Record, Bates No. 000877 (precise Bates No. uncertain, as complete, Bates-stamped copy of the Record was not provided to Applicants).
[27] *Id.*
[28] *See* Record, Bates Nos. 000759, 000761, 000765, 000777, 000779, and 000805.
[29] *See* Record, Bates No. 000765, *et seq.* (precise Bates No. uncertain).
[30] Enforcement's Pre-Hearing Brief, filed June 17, 2011, p. 27; Record, Bates No. 000805, *et seq.* (precise Bates No. uncertain).
[31] Respondent's Witness List, dated June 17, 2011; Record, Bates No. 000761.
[32] *Id.*
[33] Enforcement's Motion to Preclude Testimony of Certain Witnesses and Objection to Respondent's Motion to Preclude One of Enforcement's Exhibits, dated July 1, 2011; Record, Bates No. 001105.

and dedication to compliance."[34] That motion was heard on July 14, 2011. Although the Hearing Officer did not officially exclude any specific witness, he strongly encouraged Applicants to limit the number of witnesses on these topics.[35]

The underlying disciplinary hearing in this matter was conducted from September 26 through September 30, 2011, and from February 6 through February 9, 2012.[36]

During the hearing, the DOE called six witnesses and introduced approximately 306 exhibits into evidence.[37] None of those witnesses testified as to the level of responsibility of a broker-dealer president or CEO for a firm's U4 and U5 filings, and none testified as to Mr. Wedbush's personal responsibility for WS's filings.[38] Nor did any of Enforcement's witnesses testify as to whether Mr. Wedbush should be suspended in any capacity.[39]

Applicants called nine witnesses, and introduced approximately 50 exhibits.[40] In light of the Hearing Officer's guidance on witnesses, and the fact that no suspension had been sought, Applicants elected not to call nine of the witnesses they had designated to testify about Wedbush's management organization.[41] Because the only sanctions apparently at issue were fines and/or censures, none of Applicants' witnesses testified as to the issue of a possible suspension, whether such a suspension would be oppressive or excessive, or to mitigating facts that would have established that no suspension was warranted.[42]

During closing argument, Enforcement did not ask for a suspension for Mr. Wedbush.[43] Because Applicants had not been given notice that the potential for a suspension was at issue and because Enforcement had never requested that a suspension be imposed, Applicants did not even address the issue of a possible suspension during closing argument.

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[34] *Id.*
[35] See Transcript of Pre-Hearing Conference, dated July 14, 2011; Record, Bates No. 001295.
[36] *See* Hearing Transcripts, dated September 26, 27, 28, 29, and 30, 2011, and February 6, 7, 8, and 9, 2012; Record, Bates Nos. 001841, 002095, 002409, 002665, 002907, 003215, 003383, 003621, and 003815.
[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] *Id.*
[41] *Id.*; *see also* Transcript of Pre-Hearing Conference, dated July 14, 2011; Record, Bates No. 001295.
[42] *See* Hearing Transcripts, dated September 30, 2011, and February 6, 7, 8, and 9, 2012; Record, Bates Nos. 002907, 003215, 003383, 003621, and 003815.
[43] *See* Hearing Transcript, dated February 9, 2012; Record, Bates No. 003815.

At the conclusion of the hearing, Applicants' counsel indicated that Applicants desired to file a post-hearing brief, in part because Enforcement cited a case (*Dennis S. Kaminski,* Exchange Act Release No. 65347 (Sept. 16, 2011)) that had not previously been cited in any pleading.[44] The Hearing Officer indicated that the Panel did not need briefs.[45] Subsequently, the NAC Decision cited the *Kaminski* case that Applicants had expressed a desire to brief.[46] Prior to the underlying Panel's issuance of the OHO Decision, neither Enforcement nor the Applicants ever briefed the issue of whether Mr. Wedbush should be suspended.

The underlying Extended Hearing Panel issued its decision on August 2, 2012. The OHO Decision was the first document in the case in which the subject of a suspension was mentioned.[47]

Applicants appealed the OHO Decision to the NAC on August 3, 2012.[48] The parties completed briefing on the appeal March 8, 2013.[49] Oral argument was conducted on July 9, 2013.[50] Seventeen months later, the NAC issued its decision.[51] This appeal followed.

3. Analysis

This case presents many issues. Two of those issues are the most significant. First, is it unfair, excessive, and oppressive to suspend an associated person without providing reasonable notice that such person might be suspended? Applicants submit that the answer is obvious. Second, amazingly, this case raises the issue of whether a suspension and a fine are functionally equivalent. Again, Applicants submit that the answer is obvious.

Applicants respectfully submit that the NAC Decision is fatally flawed in numerous respects, the most egregious of which was the total deprivation of fair notice to Applicant Edward

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[44] *Id.*
[45] *Id.*
[46] Extended Hearing Panel Decision, dated August 2, 2012, p. 40, n. 71; Record, Bates No. 007443, *et seq.* (precise Bates No. in Record uncertain).
[47] Extended Hearing Panel Decision, dated August 2, 2012; Record, Bates No. 007443.
[48] Respondents' Notice of Appeal, dated August 3, 2012; Record, Bates No. 007491.
[49] *See* Respondents' Opening Brief, dated January 3, 2013, Enforcement's Brief, dated February 22, 2013, and Respondent's Reply Brief, dated March 8, 2013; Record, Bates No. 007709, 007751, and 007775. It should be noted that Enforcement graciously granted Applicants several extensions of time owing to a medical situation (which subsequently resolved favorably).
[50] *See* Hearing Transcript, dated July 9, 2013; Record, Bates No. 007835.
[51] Notice of NAC Decision and NAC Decision, dated December 11, 2014; Record, Bates No. 007909.

Wedbush that the underlying disciplinary proceeding might result in his suspension. The NAC exacerbated the flaws in the underlying OHO Decision, by, among other things, holding that a suspension and a fine are functionally equivalent, and then increasing the suspension to Mr. Wedbush.

In addition, the facts established at the hearing do not support the Decision, and several of the findings and conclusions reached by the Panel are clearly erroneous.

A. STANDARD OF REVIEW.

The proper standard of review for self-regulatory disciplinary actions is the preponderance of the evidence standard, based on an independent review of the record.[52] For purposes of sanctions, if the Commission, having due regard for the public interest and the protection of investors, finds that a sanction imposed by a self-regulatory organization upon such a member, or person associated with a member, is excessive or oppressive, the Commission may cancel, reduce, or require the remission of such sanction.[53]

B. THE SUSPENSION IMPOSED ON MR. WEDBUSH IS IMPROPER, EXCESSIVE AND OPPRESSIVE.

This NAC Decision, if upheld, would constitute a gross miscarriage of justice. The Securities Exchange Act of 1934 (the "Exchange Act") requires that self-regulatory organization rules provide "a fair procedure for the disciplining of members and persons associated with members."[54] Among other things, the "fair procedure" requirement obligates self-regulatory organizations to provide members and associated persons with proper notice of disciplinary proceedings, including proper notice of potential sanctions:

> In any proceeding by a registered securities association to determine whether a member or person associated with a member should be disciplined...the association shall bring specific charges, notify such member or person of, and give him an opportunity to defend against

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[52] *See David M. Levine*, Exchange Act Release No. 48760, 2003 SEC LEXIS 2678, at *36 n. 42 (Nov. 7, 2003) *Gregory Even Goldstein*, Exchange Act Release No. 71970, p. 5 (April 17, 2014.)

[53] 15 U.S.C. § 78s(e)(2).

[54] Exchange Act § 15A(b)(8).

such charges.[55]

In the case of a proceeding to bar or suspend an associated person, a securities association is required to "notify such person and give him an opportunity to be heard upon, the specific grounds for...[a] bar or [suspension] under consideration."[56] Although Section 15A(h)(2) of the Exchange Act does not use the word "suspensions," it references "prohibitions" and "limitations," and a suspension is certainly a limitation. Moreover, if it is Enforcement's position that registered representatives are not entitled to specific notice of the charges against them, and the specific type of punishment sought, such a system is unfair on its face.

In this case, Applicants were denied a fair procedure because they were not provided with adequate notice of or a fair opportunity to be heard upon the suspension "under consideration." In fact, they were never informed that a suspension was "under consideration." Applicants were informed by Enforcement that they were being charged with various violations based on late filings of various regulatory reports. They were further informed that as a result of these charges, Enforcement sought a fine of $250,000 against Applicants WS, and a censure and a fine of $50,000 against Mr. Wedbush. Enforcement specifically noted that they were not seeking "time off" for Mr. Wedbush. Applicants prepared and presented a defense to these charges, and these requested sanctions. The Hearing Panel then issued a Decision that included monetary sanctions against WS of $300,000, a fine against Mr. Wedbush of $25,000, and, most astonishingly, a 31-day supervisory suspension of Mr. Wedbush. The Exchange Act requires Applicants to be put on fair notice of the potential sanctions against them.

1. Applicants Were Not Informed That Mr. Wedbush Might Be Subject To A Suspension.

Basic notions of fairness require that a respondent in an administrative proceeding be provided with notice of not only the charges against him, but the punishment sought. Such notice is a fundamental right and is required so that a person accused of wrongdoing is able to

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[55] Exchange Act § 15A(h)(1).
[56] Exchange Act § 15A(h)(2).

defend himself. Without proper notice, a person accused of wrongdoing is ambushed and deprived of the ability to prepare for trial and to present evidence and argument at trial concerning the issues as to which he has been denied notice. Such notice also is required so that persons accused of wrongdoing can make informed decisions concerning settlement.

As Enforcement noted at the very beginning of its opening statement in the underlying proceeding, the "securities industry relies upon disclosure, timely disclosure and adequate disclosure."[57] Applicants in disciplinary proceedings also rely on timely and adequate disclosure. In short, a respondent should know what he faces when he enters the room.

This case raises the issue of the stage during a FINRA disciplinary proceeding at which FINRA should specifically inform a registered representative of the type of punishment it seeks. As noted in it briefs to the NAC, Applicants submit that there are several such stages that might be reasonable: the Wells Notice; the complaint; an amended complaint; and perhaps, in an unusual case, as far down the road as the pre-hearing brief. Enforcement's position is that such specific notice is timely even if it is not provided until after the hearing. This is absurd.

Enforcement was not silent on the issues of sanctions. On the contrary, it specifically informed Applicants of the precise sanctions it sought. It did so on at least four occasions: in three versions of the complaint; and in its pre-hearing brief.[58] In addition, Enforcement made an opening statement and a closing argument.[59] In each one of these notifications, Enforcement indicated that Applicant WS had potential exposure of up to $250,000, and that Mr. Wedbush had potential exposure of a censure and a fine of up to $50,000.[60] At no time did Enforcement provide any indication to Applicants that it sought any suspension, in any capacity, for any length of time, against Mr. Wedbush.

This failure of Enforcement and the Hearing Panel to provide reasonable notice to Mr. Wedbush that a suspension might result prejudiced Applicants' defense in several significant

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[57] Hearing Transcript, dated September 26, 2011, p. 11: 2-4; Record, Bates No. 001841, *et seq.*

[58] *See* Complaint, dated October 4, 2010, Amended Complaint, dated January 11, 2011, Enforcement's Pre-Hearing Brief, dated June 17, 2011, and Second Amended Complaint, dated June 20, 2011,; Record, Bates No. 000001, 000253, 000805, and 000877.

[59] *See* Hearing Transcripts, dated September 26, 2011 and February 9, 2012; Record, Bates No. 001841 and 003815.

[60] *Id.*

ways. First, and most obvious, it affected Applicants' hearing strategy. Virtually every aspect of a respondent's defense strategy is affected by the potential punishment. At every stage of the underlying disciplinary proceeding – preparation of the answer, selection of witnesses, selection of exhibits, decisions as to stipulations, pre-hearing briefs, witness examinations – Applicants were prejudiced in their defense preparation and strategy by Enforcement's indication that it was not seeking any "time off" for Mr. Wedbush.

Second, the lack of fair notice to Mr. Wedbush prejudiced Applicants in the arguments that they made during the underlying hearing. As noted above, having had no reasonable notice that a suspension was a possibility, Applicants did not address such a suspension in any of their arguments during the underlying proceeding. Applicants' pleadings, brief, opening statement, and closing arguments are devoid of even a mention of whether a suspension is appropriate.

Third, it affected the number and type of witnesses that Applicants called. Rather than call the 22 witnesses they originally designated, Applicants – at the urging of the Hearing Officer – limited their witnesses to 9. Although some of these witnesses testified as to Mr. Wedbush's work ethic and dedication to compliance, Applicants would have elicited significantly more, and different, testimony on this issue had Enforcement or the Panel provided some notice that a suspension was possible.

Fourth, Applicants stipulated to numerous reporting violations. In fact, of the 81 "Items" purportedly constituting reporting violations, Applicants challenged only 12. Applicants conceded that another 10 were violations, but Applicants showed that the fault in those instances lay with an individual broker or manager rather than the firm or Mr. Wedbush. Applicants stipulated that the remaining 59 Items constituted reporting violations. Had they known that a suspension or a fine exceeding $250,000 was possible, they might have challenged some or all of those 59 Items.

The issue of the stipulations is noteworthy because Enforcement successfully introduced evidence – over Applicants' objections – pertaining to several of the Items as to which Applicants had stipulated. In response to the objections, Enforcement indicated that the evidence

was relevant to sanctions. Had they known that evidence pertaining to the stipulated Items would be admitted and considered to support the imposition of a suspension, Applicants certainly would not have stipulated to such Items.

The fact that the NAC reviewed this proceeding on a *de novo* standard does not cure this problem. As every litigator knows, a fair initial hearing is crucial to a fair outcome. Decisions in the early stages of a case can and often do affect later proceedings in the case. In this case, the Record consists of approximately 8,000 pages. Nearly 7,500 of those pages consist of pleadings and evidence that was submitted before the NAC saw a single page. Failure to provide Applicants reasonable notice that Mr. Wedbush might be suspended effectively undercut Applicants' defense.

In its decision, the NAC conceded that Enforcement at no point specifically argued or even requested that Mr. Wedbush be suspended.[61] But like Enforcement, the NAC concluded that the "catch all" remedy set forth in FINRA Rule 8310(a) put Applicants on sufficient notice that Mr. Wedbush might be suspended.[62] The NAC Decision cites three cases in support of this finding.[63] None of these cases supports NAC's findings.

First, the NAC Decision cites the case of *William C. Piontek*, 57 S.E.C. 79, 90-91 (2003).[64] The NAC summarizes that case as follows: "finding that respondent who 'understood the issue[s]' and 'was afforded full opportunity' to litigate...had sufficient notice of the charges against him and an opportunity to prepare and present his defense."[65] That summary is inadequate, at best, when used to support the proposition that a request for sanctions under FINRA Rule 8310(a) provides a respondent with sufficient notice that they might be suspended.

The *Piontek* case did not involve a respondent who claimed he did not know that he might be suspended.[66] The *Piontek* decision does not have <u>any</u> bearing on that issue. That case

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[61] *See* Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 34, n. 66; Record, Bates No. 007909.
[62] *See* Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 19; Record, Bates No. 007909.
[63] *See* Notice of NAC Decision and NAC Decision, dated December 11, 2014, pp. 19, 34; Record, Bates No. 007909 (specific Bates No. unknown).
[64] Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 19; Record, Bates No. 007909.
[65] *Id.*
[66] *In Re Piontek*, Release No. 8344, Securities Exchange Act Release No. 48903, at *5 (December 11, 2003.)

involved a respondent who claimed that enforcement (the SEC, in that case) did not identify a specific customer account that was at issue "until the commencement of the hearing" (although it had specifically identified the other account at issue).[67]

Notably, the *Piontek* case would not support the NAC Decision even if it did concern the issue of sufficient notice of a potential suspension. In that case, respondent *Piontek* was notified at "the commencement of the hearing" of the specific customer account at issue.[68] That customer was on enforcement's witness list, and his participation was discussed at the pre-hearing conference.[69] Respondent Piontek was able to review documents, question the witness "before his testimony and at the hearing, and otherwise fully prepare his case."[70] Nothing like that happened in this case. On the contrary, in this case, Applicants were not specifically informed that a suspension was in play at the commencement of the hearing, or even during the hearing. They were not able to review documents, or question witnesses before their testimony and at the hearing, and 'otherwise fully prepare their case,' with the knowledge that one potential outcome of the case was that Mr. Wedbush might be suspended. Instead, Applicants were blind-sided with a post-hearing remedy that had never been discussed at any stage of the proceedings.

Second, the NAC decision cites the case of *Bison Securities, Inc.*, 51 S.E.C. 327, 51 SEC LEXIS 725, *17 (Mar. 23, 1993), describing it as "holding that Article V, Section 1 of NASD Rules, which was substantially similar to FINRA Rule 8310(a), 'provides adequate notice of the possible sanctions a violator might face.'"[71] The *Bison* case does not support the proposition that a general citation to Rule 8310(a) puts a respondent on notice that they may be subject to a suspension. In *Bison*, the respondents did not claim that Enforcement failed to notify them of the sanctions sought.[72] Instead, they claimed they "were not on notice of possible sanctions" because the Sanctions Guidelines had "not been made public."[73] Applicants do not dispute that they were

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[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 19; Record, Bates No. 007909.
[72] *Bison*, 1993 SEC LEXIS at *17.
[73] *Id.*

aware of the Sanctions Guidelines. But having never been told that Enforcement or the underlying Hearing Panel were considering a suspension, Applicants were not on notice the Mr. Wedbush might be suspended as a result of this case. *Bison* is 100% silent on whether FINRA should at some point prior to rendering a decision tell a specific respondent that a suspension is sought in that case. It has no bearing on this case.

Finally, the NAC Decision cites the case of *Caruselle v. New York Mercantile Exchange*, 2005 CFTC LEXIS 64, *8 (June 21, 2005).[74] That CFTC case does not hold that FINRA adjudicators may impose different types of sanctions than Enforcement seeks. It does not even address the issue of whether Enforcement or the Hearing Panel should inform a respondent that he or she might be suspended. The Commission in that case simply held that it could issue a suspension longer than the suspension sought by Enforcement.[75] In this case, Enforcement sought no suspension.

Enforcement's reliance on the Sanctions Guidelines is similarly unavailing. The fact that the Guidelines were designed so that "associated persons, and their counsel may become more familiar with the types of disciplinary sanctions that may be applicable to various violations" does not tell such associated persons what specific sanctions may be applicable in a specific case.[76] That is the purpose of pleadings. Even in a civil case, in which some plaintiffs pray for damages "in an amount presently unknown, but to be proven at trial," such plaintiffs at some point must ask for a specific amount of damages. In this case, Enforcement never asked for a suspension. Even if it had waited until opening statement, Applicants would have had some opportunity to adapt their case, and put on rebuttal evidence.

Permitting Enforcement to bar or suspend associated persons based on such catch-all relief requests would render meaningless the "prayer" section of Enforcement complaints. All FINRA respondents would be forced to act as if all disciplinary proceedings raised the possibility of sanctions up to and including a possible bar. Indeed, each respondent would have to put on

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[74] Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 34; Record, Bates No. 007909.
[75] *Caruselle*, 2005 CFTC LEXIS at *8
[76] Enforcement's Brief, p. 7 (quoting the *Sanction Guidelines* at 1 (2011 Ed.)).

evidence and argument in each case showing why he or she should not be barred (in addition to evidence and argument relating to each of the lesser available sanctions). Such a procedure is prejducial and unfair on its face.

2. The Failure to Notify Applicant Wedbush that he might be suspended makes the process unfair, and the sanction excessive and oppressive.

As noted above, the NAC upheld (and increased) the suspension. It wholly dismissed Applicants' objection that they had not been provided fair notice that Mr. Wedbush might be suspended. The NAC's stated reason for dismissing that objection was its belief that no "distinction exists" between a fine and a suspension.[77] That conclusion is incorrect as both a matter of fact and law.

First, as a matter of fact, it is obvious to any person with brokerage experience that the difference between a fine imposed on a broker-dealer's president, and a suspension imposed on that president, is a difference of kind, not degree. Moreover, a brief review of the FINRA Sanctions Guidelines shows that FINRA believes they are different: they separate the fines and the suspensions into separate columns. Even a cursory review of the descriptions indicating which sanction types should be applied to various violations shows the sanctions are different.

Second, as a matter of law, fines and suspensions are different. Proceedings to impose penalties are different from proceedings to suspend or bar a person.[78] The Second Circuit has noted that exercising the power to revoke or suspend a license is "drastic."[79] Several cases have held that the five-year federal statute of limitations does not apply to proceedings seeking to impose suspensions or bars, because such proceedings are different from proceedings seeking to impose civil penalties.[80] In short, it is simply not true that there is no distinction between a fine and a suspension. There is a significant difference between a "relatively minor" sanction such a

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[77] *See* Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 20; Record, Bates No. 007909, *et seq.* (exact Bates No. uncertain, as Applicants were not provided with a complete copy of the Record).

[78] *In re Howard F. Rubin*, Exchange Act Release No. 35, 179, 58 S.E.C. Docket 1426, 1994 WL 730446, at *1.

[79] *Arthur Lipper Corp. v. S.E.C.*, 547 F.2d 171, 184 (2d Cir. 1986) (quoting Jaffe, *Judicial Control of Administrative Action* 270-271 (1965)).

[80] *See In the Matter of Timothy Mobley*, Release No. 69, WL 442160, at *1 (July 14, 1995); *In the Matter of George Craig Stayner, CPA*, Release No. 65, WL 297287, at * 15 (May 8, 1995).

fine, and a "drastic" sanction such as a fine.

3. Even If Proper Notice Had Been Given, The Suspension And Failure to Supervise Finding Are Both Excessive and Improper.

In addition to the due process problems with the suspension imposed by the Hearing Panel, and upheld by the NAC, the failure to supervise finding and resulting sanction are improper in that they are grossly excessive, for at least three reasons. First, the NAC Decision does not sufficiently justify why a suspension is appropriate in this particular case. Section 19(a)(3) of the Exchange Act "authorizes an order of expulsion not as a penalty, but as a means of protecting investors."[81] "It is familiar law that the purpose of expulsion or suspension from trading is to protect investors, not to penalize brokers."[82] Although deterrence may constitute an additional justification for sanctions, "general deterrence is not, by itself, sufficient justification for expulsion for suspension."[83]

In this case, the NAC Decision is effectively silent on whether Mr. Wedbush's suspension would provide any protection to the investing public. Although the decision makes a generalized statement that the purpose of the sanction included "the purpose of protecting investors," it does not explain, or even attempt to explain, how suspending Mr. Wedbush for 31 days would protect any investors.[84] Mr. Wedbush is the President of the firm. This case involved regulatory filings. Mr. Wedbush does not make those filings, or supervise any person who does. The conclusion that suspending Mr. Wedbush in a principal capacity will somehow protect the investing public is absurd on its face. Mr. Wedbush's suspension is wholly punitive. Sanctions for such a purpose are impermissible.[85]

Second, this was not a case of egregious misconduct. There was no fraud or other

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[81] *Wright v. Securities and Exchange Commission*, 112 F.2d 89, 94 (2nd Cir. 1940); *Associated Securities Corporation v. Securities and Exchange Commission*, 283 F.2d 773, 775 (10th Cir. 1960) ("Exclusion from the securities business is a remedial device for the protection of the public.").

[82] *McCarthy v. S.E.C.*, 406 F.3d 179, 188 (2nd. Cir. 2005).

[83] *McCarthy*, 406 F.3d at 189.

[84] *See* Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 35; Record, Bates No. 007909 (specific Bates No. unknown).

[85] *In re Howard F. Rubin*, Exchange Act Release No. 35, 179, 58 S.E.C. Docket 1426, 1994 WL 730446, at *1 ("It is well-settled that such administrative proceedings are not punitive but remedial. When we...suspend a person, it is to protect the public from future harm at his or her hands.")

intentional malfeasance. No public customer was directly harmed.[86] There was no gain, pecuniary or otherwise, to Applicants. This was a case of U4, U5, RE-3, and 3070 filings that were late.[87] Nothing more was at issue. A suspension on such grounds is excessive on its face.

Third, the suspension was not commensurate with other FINRA sanctions for similar violations, including alleged violations in this case. For example, former NASD employee Charles Huang was the Chief Compliance Officer and manager of the WS Business Conduct Department for a period of approximately one year. During that time, the firm had a 100% failure rate on RE-3 forms. Despite this high failure rate, Mr. Huang was issued a non-public Cautionary Action Letter. No other sanction was issued: no fine; no public censure; and certainly no suspension.

The late reporting rates at issue in the case against Mr. Wedbush varied by time period and type of filing, but none were as high as 50%, yet Mr. Wedbush was found guilty of a failure to supervise, and was suspended.[88] Mr. Wedbush was the WS Chief Compliance Officer for less than 20% of the time period at issue. He undertook that role in order to assess the needs of the Business Conduct Department, not to directly supervise U4 and U5 filings. Yet other than Mr. Huang's non-public reprimand, none of the other chief compliance officers were even charged in this case, let alone disciplined.

Similarly, the excessiveness and oppressiveness of Mr. Wedbush's supervisory sanction is apparent from a review of two other cases of late filings. The first case involved UBS Financial Services. In that case, UBS was fined $370,000. The violations included more than 550 late filings (compared to 160 alleged late filings in this case), plus a failure to disclose at least 24 customer complaints on U4 or U5 forms (compared with 5 in this case), and U5 "Termination"

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[86] Enforcement contended that public customers could have been harmed if they looked up a broker on Brokercheck, and a reportable issue had not been timely disclosed. While this is true, it is also purely theoretical. Enforcement presented no evidence of any customer who took any action based in whole or in part on an untimely regulatory filing.

[87] In a few cases, the filings were not made at all because the firm believed they should not or could not be made.

[88] In its Decision, the NAC indicated that it saw "nothing in the record" to support the assertion that Mr. Huang received a lighter sanction because he was a former NASD employee. NAC Decision, p. 34. Applicants assert that the appearance of impropriety is manifest.

notices filed late at a rate of 64%.[89] No individual was sanctioned or even charged in that case, let alone the firm president.[90] Moreover, the DOE's first witness in this case, Mario Di Tripani, happened to have been employed at UBS during the time period for which UBS was sanctioned, and he was in the position of supervising the filing of the same types of regulatory filings that were at issue in this case.[91] In other words, Mr. DiTripani oversaw late filings nearly identical to the late filings for which Mr. Wedbush was charged. Mr. DiTripani was not charged in the UBS case, and testified that he should not have been charged.[92] Nor was the the UBS chief executive officer charged in that case.[93]

The second case involved Merrill Lynch. During a time period similar to that in this case, Merrill Lynch was charged with nearly 1,000 reporting violations (compared with 160 charged reporting violations in this case), and settled the claim for $500,000.[94] Merrill Lynch is obviously larger than Respondent WS, but its failure rates were similar to or higher than those of WS (including a failure rate of 100% for a period of more than two years).[95] No individuals, let alone the firm president, were suspended, or even charged.

In this case, the Panel made a finding of failure to supervise and imposed the sanction of a 31-day supervisory suspension on Mr. Wedbush, despite the fact that the DOE did not ask for any suspension for Mr. Wedbush. In the Merrill Lynch and UBS cases, no individuals, let alone the firm presidents, received any suspension or failure to supervise finding, or any sanction whatsoever, in connection with the failures at those firms. The sanctions imposed against Mr. Wedbush are clearly excessive and improper.

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[89] Applicants' Exhibit RX-GG, pp. 1-2; Record, Bates No. 007351.
[90] *Id.*
[91] Hearing Transcript, dated September 27, 2011, p. 264, l. 21 – p. 265, l. 24; Record, Bates No. 002095, et seq. (exact Bates No. unknown to Applicants).
[92] Hearing Transcript, dated September 27, 2011, p. 266, ll. 4-8; Record, Bates No. 002095, et seq. (exact Bates No. unknown to Applicants).
[93] Hearing Transcript, dated September 27, 2011, p. 266, ll. 2-3; Record, Bates No. 002095, et seq. (exact Bates No. unknown to Applicants).
[94] Applicants' Exhibit RX-AAA; Record, Bates No. 007575.
[95] *Id.*

C. THE NAC DECISION IS FLAWED IN SEVERAL OTHER RESPECTS.

In addition to the excessive and improper sanction issued to Respondent Edward Wedbush, the NAC Decision should be reversed because the record does not support the Panel's findings and conclusions, for several reasons.

1. Enforcement Did Not Introduce Any Evidence On Mr. Wedbush's Responsibility for Wedbush Regulatory Filings.

Applicants take exception to the NAC finding that Mr. Wedbush had responsibility for the regulatory filings at issue. The NAC Decision upholds sanctions on Mr. Wedbush for "failure to supervise," but the record contains no evidence of Mr. Wedbush's personal level of responsibility for the firm's failure to making certain regulatory filings on a timely basis. It is undisputed that Mr. Wedbush had no responsibility to personally make or directly supervise the filings at issue. It is also undisputed that for the majority of the time period at issue, the individuals responsible for making such filings were several levels below Mr. Wedbush in the firm's reporting structure. Although Mr. Wedbush for a time assumed the role of WS Chief Compliance Officer, no other WS Chief Compliance Officer received any public discipline.

Accordingly, the only logical conclusion is that Mr. Wedbush was found guilty of lack of supervision simply because he was the firm's president. Yet the record is wholly devoid of any evidence as to whether a firm president has such responsibility and may be sanctioned for the firm's untimely regulatory filings. Enforcement put on no evidence on this point. No witness testified that Mr. Wedbush has such responsibility. There was no expert testimony. No exhibits were introduced on this topic. Enforcement did not offer any legal arguments supporting culpability on the part of Mr. Wedbush.

The record shows that Mr. Wedbush's role at WS was that of manager rather than supervisor.[96] Several witnesses testified that Mr. Wedbush oversaw numerous aspects of the firm's operations, but that he was not personally responsible for regulatory filings. Except for the

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[96] Indeed, it was and remains Mr. Wedbush's position that it would be physically impossible for Mr. Wedbush to do detailed supervision, rather than overall firm management, and that Wedbush has succeeded where other firms such as Lehman and Merrill have either failed or required billions of dollars in government assistance precisely because he focuses on firm management rather than detailed supervision.

brief period during which Mr. Wedbush assumed Chief Compliance Officer responsibilities, he did not supervise any individual who was responsible for regulatory filings.[97] But here again, Enforcement put on no evidence of the level of responsibility of a Chief Compliance Officer for untimely filings.

2. The Hearing Panel Improperly Sanctioned Applicants Based On Procedures That Enforcement Did Not Challenge.

Applicants take exception to the NAC's finding that the adequacy of the firm's supervisory system was not at issue in this case, and its conclusion that the Business Conduct Department's personnel were not qualified to carry out their compliance and reporting obligations. The NAC decision contains the following assertion: "The adequacy of the Firm's supervisory system...is not at issue in this case."[98] On the next page, the NAC Decision contains the following conclusion: "The Firm's relegation of the Business Conduct Department to an administrative role...was unreasonable under the circumstances."[99] These two statements are not consistent. The Business Conduct Department's "administrative role" was part of WS's supervisory system.

Enforcement went out of its way to note that it was not challenging Wedbush's procedures.[100] But this was the procedure. Business Conduct's role was largely administrative. Both the OHO Decision and the NAC Decision said that such a role was not a reasonable system. The NAC Decision holds that this was unreasonable because the Business Conduct Department purportedly lacked the experience, and ability to enforce the firm's procedures.[101] This "unreasonable" system was one of the bases for the sanctions imposed on Applicants. Because Enforcement did not challenge WS's procedures, Applicants were sanctioned without being provided proper notice. If WS's procedures are inadequate (which WS disputes), that issue

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[97] And even during this period, the U4 and U5 filings made by Gigi LeGarda were directly supervised by Jonathan Carr, not Mr. Wedbush.

[98] Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 14; Record, Bates No. 007909 (specific Bates No. unknown).

[99] Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 15; Record, Bates No. 007909 (specific Bates No. unknown).

[100] Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 14; Record, Bates No. 007909 (specific Bates No. unknown).

[101] Notice of NAC Decision and NAC Decision, dated December 11, 2014, p. 15; Record, Bates No. 007909 (specific Bates No. unknown)

requires an entirely separate hearing, in which WS is provided with notice that its procedures are inadequate. It is not appropriate to charge Mr. Wedbush and the firm with a failure to supervise, and then find them guilty on the ground that the procedures are inadequate, when those procedures have not been challenged.

Moreover, the NAC Decision is prejudicial in that it places substantial blame on the Business Conduct Department (notwithstanding its limited role), despite the fact that Enforcement introduced little or no evidence that Business Conduct employees neglected their duties. There is little or no evidence in the record of filings that were forwarded to Business Conduct in a timely manner, and for which Business Conduct neglected to make a timely filing. On the contrary, the record shows that in most cases, individual late filings were not the fault of Business Conduct. They were the fault of individual advisors, managers, or other employees outside of Business Conduct who failed to get information to the Business Conduct Department in a timely fashion. The record shows that Mr. Wedbush addressed this issue numerous times at Saturday management committee meetings.

While directing any blame to the appropriate elements with the Firm does not relieve WS of its obligations, the fact remains that both Applicants were sanctioned based on procedures found to have been unreasonable (placing Business Conduct in an administrative role), without having been provided notice that those procedures were at issue.

3. The Hearing Panel Erroneously Found that Evidence of Improvement was "Inconclusive."

Applicants take exception to the finding that Applicants' measures to improve regulatory reporting were ineffective. In the OHO Decision, the Hearing Panel concluded that evidence of improvement was "inconclusive." As set forth in its NAC appellate briefs, the evidentiary record convincingly belies this conclusion, in at least two respects.

First, Applicants were not charged in this case with late reporting of U5 "Terminations," but the DOE put on evidence of WS's late reporting of such U5's for the period of 2003-2005. Specifically, it introduced documents and testimony concerning an AWC the firm entered into concerning 23 untimely U5 Termination notices. Applicants introduced evidence

showing that the firm improved to a nearly 100% timely reporting rate for such filings over the last several years. That evidence also shows that this improvement was due in large part to Mr. Wedbush's management efforts. The Hearing Panel's conclusion that evidence of improvement was "inconclusive" is absurd, and both Decisions should be overturned on this basis alone.

Second, Applicants put on overwhelming evidence that their reporting rates for the specific types of regulatory filings for which Applicants had been charged had improved dramatically as a result of Mr. Wedbush's management and leadership, and that for the past several years, WS's reporting rate was well within the industry standard. For example, from September 2010 through August 2011, the industry average was 21% late, while WS's filings were late 18% of the time. Inasmuch as the DOE alleged that WS's filings during the relevant period were 40% late or more, WS's improvement to less than 20% late can hardly be called "inconclusive." Indeed, such a broad and inaccurate description of a key issue in the case warrants reversal of the entire Decision.

The NAC Decision agreed with Applicants in one respect – the NAC, too, disagreed that evidence of improvement was inconclusive. But the NAC Decision disagrees in the other direction – despite the evidence, the NAC concluded that there was no such improvement. This conclusion flies in the face of the evidence. While the improvement may have been slower than all parties would have liked, the fact remains that uncontroverted evidence shows that Applicants eventually showed massive improvement.

The NAC Decision's conclusion that Mr. Wedbush admitted "he took no direct steps to address the reporting problems" is not supported by the evidence. The evidence is undisputed that Mr. Wedbush raised this issue at many management meetings. The evidence is further undisputed that those efforts led to a near-100% improvement in U5 Termination reporting. The NAC can of course dispute whether Applicants' efforts were effective, but the blanket statement that he took "no direct steps" is not accurate.

4. Conclusion

For all of the foregoing reasons, Applicants respectfully submit that the NAC Decision should be reversed, and the sanctions imposed should be vacated. In the alternative, the

case should be remanded for a new hearing before a different Panel.

Respectfully Submitted,

Dated: March 26, 2015

By: _____
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