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7
8 **UNITED STATES OF AMERICA**
BEFORE THE
9 **SECURITIES AND EXCHANGE COMMISSION**

10
11
12 In the Matter of the Application of
13 NEWPORT COAST SECURITIES, INC.,
14 DOUGLAS A. LEONE, AND ANDRE V.
LABARBERA

15 For Review of Disciplinary Action Taken by
16 FINRA

OPENING BRIEF OF APPLICANT
NEWPORT COAST SECURITIES, INC.

Admin. Proc. File No. 3-18555

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23
24
25
26
27
28

TABLES OF CONTENTS

1

2 MEMORANDUM OF POINTS AND AUTHORITIES1

3 INTRODUCTION1

4 STATEMENT OF FACTS AND PROCEDURAL HISTORY2

5 A. Newport Coast Securities, Inc. Investigation.....4

6 ANALYSIS.....7

7 ARGUMENT.....8

8 I. LEGAL STANDARD8

9 II. HO AND NAC HEARING OFFICERS, WHO PRESIDE OVER FINRA

10 ENFORCEMENT HEARINGS, ARE SUBJECT TO THE APPOINTMENT

11 CLAUSE IN LIGHT OF THE *LUCIA* RULING8

12 A. OHO AND NAC HEARING OFFICERS ARE IMPROPERLY

13 ESTABLISHED BY FINRA RULES9

14 B. OHO AND NAC OFFICERS EXERCISE SIGNIFICANT

15 AUTHORITY10

16 III. THE OHO AND NAC DECISION IS THE RESULT OF A

17 PROCEDURALLY UNFAIRPROCESS IN VIOLATION OF THE

18 EXCHANGE ACT AND FINRA RULES12

19 IV. NEWPORT’S EXPULSION SHOULD BE VACATED BECAUSE IT IS

20 UNWARRANTED, EXCESSIVE, OPPRESSIVE AND PUNITIVE

21 EXPULSION OF15

22 A. NEWPORT IS DISPROPORTIONATELY PUNITIVE.....15

23 B. THE EXPULSION SANCTION IS A SEVERE UNDUE BURDEN

24 ON COMPETITION FOR EMPLOYERS OF AFFILIATED OR

25 FORMER EMPLOYEES OF NEWPORT17

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1
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3
4
5
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8
9
10
11
12
13
14
15
16
17
18
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20
21
22
23
24
25
26
27
28

C. THE SANCTIONS SHOULD BE STAYED ON THE GROUNDS
THAT IT DISPROPORTIONATELY PUNISHES AFFILIATED
REGISTERED REPRESENTATIVES19

CONCLUSION.....20

TABLE OF AUTHORITIES

CASES

Blinder, Robinson & Co. v. SEC (D.C. Cir. 1988) 837 F. 2d 1099 ----- 15

Buckley v. Valeo, 424 U.S. 1----- 10

David M. Levine, Exchange Act Release No. 48760, 2003 SEC Lexis 2678, at *36 n. 42 (Nov. 7, 2003) ----- 8

Department of Enforcement v. CapWest Securities, Inc., Lakewood, CO, Complaint No. 200701058001, dated February 25, 2013, at p. 12, fn. 24 ----- 16

Edmond v. United States, 520 U.S. 651 (1997) ----- 14

Freytag v. Commissioner, 501 U.S. 868 (1991) ----- 10, 11, 14

Gregory Even Goldstein, Exchange Act Release No. 71970, p.5 (April 17, 2014.)----- 8

Lucia, et al. v. SEC, No. 17-130, 2018 U.S. LEXIS 3836, at *2 (June 21, 2018)----- passim

McCarthy v. S.E.C., 406 F. 3d 179 (2nd Cir. 2005)----- 19

Paz Securities, Inc. et al. v. SEC, 494 F.3d 1059 (D.C. Cir. 2007) ----- 8, 16

Rooms v. SEC (10th Cir. 2006) 444 F. 3d 1208----- 16

Saad v. SEC (D.D.C. 2013) 718 F. 3d 904 ----- 15

United States v. Germaine, 99 U.S. 508 ----- 10

RULES

FINRA Rule 3170 ----- 6, 17

FINRA Rule 9311 ----- 5

FINRA Regulation By-Laws, Art. V, Sections 5.1, 5.3 ----- 10

FINRA Regulation By-Laws, Art. V, Sections 5.3----- 10

FINRA Rule 9000 series ----- 10

REGULATIONS

15 U.S.C. § 78o-3(b)(8) ----- 15, 16

15 U.S.C.S. §§ 78a *et seq* ----- 10, 15

1 15 U.S.C. §§ 78a ----- 15
2 Securities Exchange Act § 15A(b)(8) ----- 12, 17
3 Securities Exchange Act § 15A(h)(1) ----- 9
4 Securities Exchange Act of 1934 § 3(a)(39)----- 1, 4, 9,15
5 Securities Exchange Act § 3(a)(3) ----- 15

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 Pursuant to the July 27, 2018 Order Scheduling Briefs in this matter, Applicant, Newport
3 Coast Securities, Inc. ("Newport" or the "Firm") submits the following Opening Brief in support of
4 its application for review by the Commission of the decision of the Financial Industry Regulatory
5 Authority's ("FINRA") National Adjudicatory Council ("NAC") dated May 23, 2018 (the "NAC
6 Decision") which determined that Newport is statutorily disqualified pursuant to Section 3(a)(39) of
7 the Securities Exchange Act of 1934 (the "Exchange Act").

8 **INTRODUCTION**

9 This appeal involves a determination of a decision of the NAC dated May 23, 2018 which
10 determined that Newport is statutorily disqualified pursuant to Section 3(a)(39) of the Securities
11 Exchange Act of 1934 (the "Exchange Act"). The NAC Decision represents the final disciplinary
12 decision of FINRA.

13 The NAC's Decision is fatally flawed in numerous respects, many of which are detailed
14 below. However, at a fundamental level, FINRA's enforcement proceedings and the NAC's
15 affirmation of the Office of Hearing Officer's ("OHO") imposition of the sanction of expulsion,
16 among other things, on Newport is void because the OHO and NAC adjudicators are inferior officers
17 of the United States who were not appointed in conformance with the requirement of the
18 Appointment Clause of the United States Constitution (the "Appointment Clause"). The Supreme
19 Court's recent opinion in *Lucia, et al. v. SEC* held that every officer with significant authority
20 established by law is an Officer of the United States, and thus subject to the Appointments Clause.
21 Where, as here, OHO and NAC officers act as adjudicators of FINRA, and ultimately, SEC
22 enforcement and disciplinary actions, they are plainly "Officers of the United States." That those
23 officers were not appointed by the "President, 'Courts of Law,' or 'Heads of Departments,'"
24 invalidates Newport's administrative proceedings as a whole and renders the OHO and NAC
25 decisions from those proceedings unconstitutional.

26 Equally significant, FINRA's disciplinary proceedings against its member are inherently
27 unfair and biased as a result of its unconstitutional and unilateral appointment of OHO and NAC
28 hearing officers.

1 The NAC Decision rests in large part on the NAC's conclusion that the ex post facto
2 expulsion of Newport was in some way remedial and served the best the interest of the investing
3 public. Such a conclusion is erroneous in both fact and law. Moreover, the obvious falsity of that
4 conclusion undermines the entire NAC Decision. A central tenet of Newport's appeal of the NAC's
5 Decision is Newport voluntarily filed a Uniform Request for Broker-Dealer Withdrawal ("Form
6 BDW"), to terminate its registration with the Commission, all SROs and all jurisdictions. FINRA
7 Enforcement notified the OHO of Newport's unilateral decision to file its Form BDW. And still,
8 among other sanctions issued, the OHO hearing panel decided to expel Newport in spite of the fact
9 that it had ceased all operations and was no longer operating as a broker-dealer.

10 As a result, the sanction of expulsion imposed against Newport and its affiliated registered
11 representatives were unwarranted, excessive, and oppressive given its punitive purpose. The NAC
12 Decision effectively dismisses Newport's argument against its expulsion by concluding that its
13 expulsion serves the remedial purpose of protecting the investing public. While in fact, the NAC's
14 Decision materially and adversely affects the rights of Newport, its former registered representatives,
15 and employees and has the collateral effect of harming the investing public.

16 Furthermore, the NAC Decision also imposes an undue burden on competition by
17 permanently marking the record of Newport's former registered representatives and employees by
18 signifying that they are from an expelled firm, regardless of the associated person's lack of
19 involvement in any alleged wrongdoing or even whether the associated person worked there at the
20 time the firm was expelled. Newport's expulsion has an impermissibly punitive effect on Newport or
21 its former employees and serves no remedial effect.

22 For these reasons, as set forth more fully below, Newport respectfully submits that the
23 Commission should vacate the sanctions issued against Newport. In the alternative, Newport submits
24 that the Commission should reverse the NAC Decision and remand this proceeding for a new hearing
25 before a properly appointed panel of OHO and NAC officers.

26 **STATEMENT OF FACTS AND PROCEDURAL HISTORY**

27 With the statutory authority to enforce the nation's securities laws, the Commission delegates
28 adjudicative and investigative tasks to FINRA, a Self-Regulatory Organization ("SRO"), in order to
regulate broker-dealers and registered representatives on behalf of the SEC. When FINRA

1 determines that violations of securities rules have occurred and formal disciplinary action is
2 necessary, either its Enforcement Department (“Enforcement”) or Market Regulation Department
3 files a complaint with the OHO.¹ The OHO and the NAC act pursuant to the by-laws of FINRA
4 Regulation and FINRA’s Code of Procedure to administer decisions in enforcement actions on behalf
5 of FINRA.²

6 As discussed above, the complaint is first filed with the OHO which arranges a three-person
7 panel to hear the case.³ The OHO hearing panel is chaired by a hearing officer, the Chief Hearing
8 Officer, who is an employee of the OHO.⁴ The Chief Hearing Officer shall appoint a Hearing Panel
9 or an Extended Hearing Panel [footnote] to conduct the disciplinary proceeding and issue a decision.
10 The Hearing Panel shall be composed of a Hearing Officer and two panelists.⁵ The Hearing Officer
11 along with the two industry panelists, are drawn primarily from a pool of current and former
12 securities industry members of FINRA's District or Regional Committees, as well as its various
13 disciplinary committees, or is a former member of the NAC and the Board of Governor of the
14 FINRA.⁶

15 At the hearing, the parties present evidence for the OHO hearing panel to determine whether a
16 firm or individual has engaged in conduct that violates FINRA rules, SEC regulations or federal
17 securities laws.⁷ In reaching its decision, the OHO hearing panel also considers previous court, SEC,
18 and NAC decisions to determine if violations occurred.⁸

19 The NAC acts on behalf of FINRA.⁹ The NAC presides over disciplinary matters that it calls
20 up for review or those that are appealed to it.¹⁰ The NAC also, when requested, in statutory
21 disqualification and membership proceedings, considers the appeals of members seeking exemptive
22 relief, and retains the authority to review decisions proposed in other proceedings as set forth in the
23

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25 ¹ *Financial Industry Regulatory Authority, The Guide to Disciplinary Hearing Process* (2018), available at
<http://www.finra.org/industry/guide-disciplinary-hearing-process#proceedings>.

26 ² *Id.*

27 ³ *Id.*

28 ⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

1 Code of Procedure.¹¹ The NAC is composed of a fifteen member panel which reviews the decision
2 rendered by the OHO hearing panel.¹² For each case, the NAC will issue a written decision
3 explaining the reasons for its ruling and consult the FINRA Sanction Guidelines to determine the
4 appropriate sanctions if violations have occurred.¹³ If the Board of Governors of FINRA does not
5 call the matter for review, the NAC's decision becomes final.

6 **A. Newport Coast Securities, Inc. Investigation**

7 Newport was a broker-dealer and investment advisory firm that was registered since 1985.¹⁴
8 Newport was a member of FINRA and registered with the SEC as an investment advisory firm.¹⁵
9 The Firm employed thousands of brokers while it was in business for over 30 years.¹⁶ On July 28,
10 2014, Enforcement filed a complaint (the "Complaint") that alleged misconduct during the period of
11 September 2008 through May 2013.¹⁷ The Complaint named eight respondents, which included
12 Newport.¹⁸ The Complaint alleged that Newport, acting through the other named respondents,
13 engaged in excessive trading in certain customer accounts, churning and, among other things, that
14 Newport lacked adequate procedures and systems necessary to supervise its registered
15 representatives' sales practices in violation of various NASD rules, FINRA rules, and Securities
16 Exchange Act of 1934 (the "Exchange Act") sections.¹⁹

17 The hearing on the Complaint took place before the OHO hearing panel over nineteen days
18 during November 2015 and January 2016.²⁰ When the OHO conducted Newport's hearing, the OHO
19 hearing panel heard testimony from thirty-two witnesses, which included some of the respondents

21 ¹¹ *Id.*

22 ¹² *Id.*

23 ¹³ *Id.*

24 ¹⁴ Certification of the Record to the Securities and Exchange Commission, filed XXXXX (hereinafter "Record"), Bates
25 No. 000001 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to Applicants).

26 ¹⁵ *Id.*

27 ¹⁶ Record, Bates No. 030021 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to
28 Applicants).

¹⁷ Record, Bates No. 000001 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to
Applicants).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Record, Bates No. 002375-7781 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not
provided to Applicants).

1 named in the Complaint and customers of Newport.²¹ The OHO hearing panel admitted into
2 evidence numerous documents and exhibits.²²

3 On August 3, 2016, Newport voluntarily filed a Form BDW, to voluntarily terminate its
4 registration with the Commission, all SROs and all jurisdictions.²³ On September 30, 2016,
5 Enforcement notified the OHO that Newport had filed its Form BDW and that its membership was
6 cancelled.²⁴ Six days later, on October 6, 2016, Enforcement notified the OHO that the SEC
7 terminated Newport's registration.²⁵

8 The OHO hearing panel decision was issued on October 17, 2016.²⁶ The OHO hearing panel
9 held that the named respondents violated federal securities laws and NASD and FINRA rules as
10 alleged in the Enforcement's multiple count complaint.²⁷ The OHO hearing panel determined that the
11 violations were closely interrelated and batched the sanctions against each respondent.²⁸ Among the
12 sanctions issued, the OHO hearing panel decided to expel Newport.²⁹

13 Newport appealed the OHO hearing panel's decision to the NAC under FINRA Rule 9311.³⁰
14 Newport's sole issue on appeal was the expulsion of the Firm.³¹

15 Newport properly argued there is no remedial purpose for the expulsion of a firm where it has
16 already voluntarily withdrawn its membership and is out of business.³² However, the NAC
17 incorrectly disagreed.³³ The NAC decided that neither Newport's tenure as a firm for 30 years nor its
18 employment of thousands of brokers through the years should insulate the firm from a sanction, such
19 as expulsion.³⁴

21 ²¹ *Id.*

22 ²² *Id.*

23 ²³ *Id.*

24 ²⁴ Record, Bates No. 029477 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to Applicants).

25 ²⁵ *Id.*

26 ²⁶ Record, Bates No. 029495

27 ²⁷ *Id.*

28 ²⁸ *Id.*

29 ²⁹ *Id.*

30 ³⁰ Record, Bates No. 029611

31 ³¹ *Id.*

32 ³² Record, Bates No. 029769 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to Applicants).

33 ³³ Record, Bates No. 030021 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to Applicants).

34 ³⁴ NAC Decision p.82, Record, Bates No. 030021 (precise Bates No. uncertain, as complete, Bates-stamped copy of record was not provided to Applicants).

1 Newport's expulsion would have a deleterious effect on its [former] Newport employees who
2 were not associated with the Complaint because they posed "no danger" and "were not engaging in
3 illegal activities at all."³⁵ Newport argued that, among other things, the [former] Newport employees
4 would unnecessarily be subject to the imposition of supervisory obligations, would likely lose a
5 significant amount of customers, and would not be able to freely associate with other customers
6 leading ultimately to termination.³⁶ The NAC was unconvinced. Enforcement argued in favor of
7 expulsion because it would trigger the tape recording of conversations at a new firm, Firm 2.³⁷
8 FINRA Rule 3170 is also known as is known as the "Taping Rule."³⁸ This rule requires a firm to
9 establish, enforce, and maintain special written procedures supervising the telemarketing activities of
10 all of its registered persons, including the tape recording of conversations, if the firm hired more than
11 a specified percentage of registered persons from firms that meet the rule's definition of "disciplined
12 firm."³⁹ In determining that the application of the Taping Rule [footnote] was not a sanction, denial
13 of membership, denial or limitation of access to services, or a bar, the NAC reasoned that employees
14 of the firm subject to the rule "remain free to associate with other firms."⁴⁰

15 The NAC also rejected Newport's argument that expelling the firm imposes an undue burden
16 on competition.⁴¹ Newport argued that expulsion has the effect of imputing the conduct of five
17 brokers to its other former registered representatives and employees by marking them as being from
18 an expelled firm.⁴² The expelled firms receive a mark on FINRA's Broker Check that goes next to
19 each firm in an associated person's work history that indicates that the firm was expelled, regardless
20 of the associated person's lack of involvement in any alleged wrongdoing, or even whether the
21 associated person worked there at the time the firm was expelled.⁴³

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24 ³⁵ Reply Brief of Newport Coast Securities Inc. pgs. 9-11, Record, Bates No. 029881 (precise Bates No. uncertain, as
complete, Bates-stamped copy of record was not provided to Applicants).

25 ³⁶ *Id.*

26 ³⁷ NAC Decision, 80, Record, Bates No. 029827 (precise Bates No. uncertain, as complete, Bates-stamped copy of record
was not provided to Applicants).

27 ³⁸ *Id.*

28 ³⁹ *Id.*

⁴⁰ *Broker Check by the Financial Industry Regulatory Authority (2018)*, available at <https://brokercheck.finra.org/>

⁴¹ NAC Decision, 81, Record, Bates No. 029827 (precise Bates No. uncertain, as complete, Bates-stamped copy of record
was not provided to Applicants).

⁴² *Broker Check by the Financial Industry Regulatory Authority (2018)*, available at <https://brokercheck.finra.org/>

⁴³ *Id.*

1 Newport argued, among other things, that although expulsion is allowed under the FINRA
2 Sanction Guidelines, that it is impermissibly punitive under the circumstances at bar.⁴⁴ The purpose
3 of expulsion should be remedial and not have a punitive effect on former Newport employees. The
4 NAC disagreed.⁴⁵ It held an expulsion serves the remedial purposes of protecting investors who may
5 be harmed by similar misconduct in the future if the firm was eligible for membership, and deterring
6 other firms from engaging in similar misconduct.⁴⁶

7 The NAC held that Newport's excessive trading, churning, qualitatively unsuitable trading,
8 and failure to supervise warranted expulsion.⁴⁷ The NAC reasoned Newport's expulsion was
9 consistent with the Sanction Guidelines.⁴⁸ The NAC determined Newport's misconduct was
10 reflective of a myriad of aggravating factors without mitigation and therefore sufficiently egregious to
11 expel the firm from FINRA membership.⁴⁹ The NAC further found that Newport's disciplinary
12 history served as an additional aggravating factors that supported expelling the firm.⁵⁰

13 On June 22, 2018, Newport filed its application for review with the SEC.

14 ANALYSIS

15 This case presents several issues. Three of those issues are the most significant. First, did the
16 OHO and the NAC hearing officers have the authority to hear these administrative proceeding when
17 they were not appointed in conformance with the requirement of the Appointment Clause of the
18 United States Constitution? Newport submits that answer is no. Second, did FINRA provide a fair
19 and impartial hearing for disciplining its members? Again, the answer to this issue is no. And, third,
20 is it unfair, excessive, oppressive and punitive to permanently expel a broker-dealer that has
21 voluntarily and unilaterally withdrawn its Form BDW and no longer poses an inherent risk to the
22 investing public? Newport submits that answer is a resounding yes.

24 ⁴⁴ NAC Decision, 81, Record, Bates No. 029827 (precise Bates No. uncertain, as complete, Bates-stamped copy of record
25 was not provided to Applicants).

26 ⁴⁵ NAC Decision, 84, Record, Bates No. 029827 (precise Bates No. uncertain, as complete, Bates-stamped copy of record
27 was not provided to Applicants).

⁴⁶ *Id.*

28 ⁴⁷ NAC Decision, 78, Record, Bates No. 029827 (precise Bates No. uncertain, as complete, Bates-stamped copy of record
was not provided to Applicants).

⁴⁸ NAC Decision, 79, Record, Bates No. 029827 (precise Bates No. uncertain, as complete, Bates-stamped copy of record
was not provided to Applicants).

⁴⁹ *Id.*

⁵⁰ *Id.*

1 Newport respectfully submits the Supreme Court's recent holding in *Lucia* makes it
2 abundantly clear that FINRA Enforcement's administrative processes is both unconstitutional and
3 inequitable.

4 Moreover, the NAC Decision is fatally flawed in numerous respects, the most egregious of
5 which was the imposition of an oppressive and excessive punishment which creates an undue burden
6 on competition.

7 As a result, the findings and conclusions reached by the OHO and NAC are clearly erroneous.

8 ARGUMENT

9 **I. LEGAL STANDARD**

10 The proper standard of review for self-regulatory disciplinary actions is the preponderance
11 of the evidence standard, based on an independent review of the record.⁵¹ For purposes of
12 sanctions, the Commission must determine whether, with "due regard for the public interest and
13 the protection of investors," that sanction "is excessive or oppressive."⁵² As part of that review,
14 the Commission must carefully consider whether there are any aggravating or mitigating factors
15 that are relevant to the agency's determination of an appropriate sanction.⁵³ This review is
16 particularly important when the respondent faces a lifetime bar, which is the securities industry
17 equivalent of capital punishment.⁵⁴

18 **II. HO AND NAC HEARING OFFICERS, WHO PRESIDE OVER FINRA** 19 **ENFORCEMENT HEARINGS, ARE SUBJECT TO THE APPOINTMENT** 20 **CLAUSE IN LIGHT OF THE *LUCIA* RULING**

21 Newport is constitutionally entitled to, at minimum, a new "hearing before a properly
22 appointed" adjudicator or the NAC Decision must be vacated because FINRA Enforcement's
23 proceeding and the NAC's affirmation of the OHO's imposition of the sanction of expulsion on
24 Newport is invalid. The Supreme Court's recent opinion in *Lucia, et al. v. SEC* makes clear that
25 every officer with significant authority established by law is an Officer of the United States, and
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28 ⁵¹ 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.)

⁵² 15 U.S.C. § 78s(e)(2)

⁵³ *PAZ Sec. Inc. v. SEC*, 494 F. 3d 1059, 1065-66 (D.C. Cir. 2007)

⁵⁴ *Id.*

1 thus subject to the Appointments Clause.⁵⁵

2 Here, because OHO and NAC officers act as adjudicators of FINRA, and ultimately, the
3 SEC enforcement and disciplinary actions, they are plainly “Officers of the United States.”⁵⁶ That
4 those officers were not appointed by the “President, ‘Courts of Law,’ or ‘Heads of Departments,’”
5 invalidates Newport’s administrative proceedings and renders the OHO and NAC decisions from
6 those proceedings unconstitutional.⁵⁷

7 Among other things, the NAC Decision, if upheld, would constitute a gross miscarriage of
8 justice. The Securities Exchange Act of 1934 (the “Exchange Act”) requires that self-regulatory
9 organization rules provide “a fair procedure for disciplining of member and persons associated
10 with members.”⁵⁸ In this case, Newport was denied a fair procedure because the administrative
11 proceedings were conducted by OHO and NAC officers that were improperly appointed by
12 FINRA staff to hear this matter and the process in which Newport was forced to participate in is
13 inherently designed to create an unbalanced and biased result.

14 **A. OHO AND NAC HEARING OFFICERS ARE IMPROPERLY**
15 **ESTABLISHED BY FINRA RULES**

16 The appointment of OHO and NAC officers pursuant to FINRA rules violates the U.S.
17 Constitution’s Appointment Clause because they were appointed by FINRA staff persons rather
18 than by the Commission itself. Supreme Court precedent, reaffirmed by the *Lucia* opinion, has
19 established the standard by which positions much like OHO and NAC hearing officers, must be
20 established.⁵⁹ The Appointments Clause requires that all “officers” of the United States be
21 appointed by the president, by the “courts of law,” or by the “heads of departments.”⁶⁰ OHO and
22 NAC hearing officers should be deemed to be the same as hearing officers under the standard set
23 by *Lucia*. Because OHO and NAC hearing officers, like the Administrative Law Judges (“ALJ(s)”)
24 in *Lucia*, were appointed by civil-service procedures promulgated by FINRA, it is plain that their
25 appointments are invalid.

26 _____
27 ⁵⁵ See *Lucia, et al. v. SEC*, No. 17-130, 2018 U.S. LEXIS 3836, at *2 (June 21, 2018).

28 ⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ Exchange Act § 15A(h)(1)

⁵⁹ See *Lucia, et al. v. SEC*, No. 17-130, 2018 U.S. LEXIS 3836, at *2 (June 21, 2018).

⁶⁰ *Id.*

1 The Supreme Court in *Lucia* established a two-part test by which a position is deemed to
2 carry the weight of an Officer of the United States. The first part of the test is whether the trier of
3 fact or “an individual [assigned to hear a matter] . . . occup[ies] a ‘continuing’ position established
4 by law to qualify as an officer.”⁶¹ Second, and as will be explained in more detail below, the
5 individual must exercise “significant authority pursuant to the laws of the United States.”⁶²

6 With regard to the first requirement, there can be no reasonable dispute that the positions of
7 OHO and NAC officers are created by FINRA By-laws and Rules of Regulation pursuant to the
8 authority of the SEC to delegate its functions.⁶³ This alone makes them “established by law.”⁶⁴
9 FINRA’s by-laws and regulations further set out the terms, duties, means of appointment, and
10 procedure for removal or recusal of both OHO and NAC officers.

11 More significantly though, these officers are not temporary, with OHO and NAC officers
12 serving specified terms. Even if OHO and NAC officers only act when assigned to individual
13 cases, their initial appointments to serve in the pool of adjudicators cannot be ignored – nor can the
14 fact that their duties and obligations are carefully crafted by FINRA rules and by-laws which are
15 supposed to be in accordance with the Exchange Act. Their very existence and the scope and
16 import of their duties are established entirely by rules promulgated by federal statute.

17 B. OHO AND NAC OFFICERS EXERCISE SIGNIFICANT AUTHORITY

18 The second part of the test is whether the adjudicator has sufficient discretion over
19 significantly important functions of the proceedings to warrant the same treatment as the *Freytag*
20 judges. Similarly, the OHO and NAC Officers exercise significant authority because, just like the
21 SEC’s ALJs in *Lucia* and the Tax Court special trial judges (“STJs”) in *Freytag*, they preside over
22 adversarial enforcement proceedings and decide the rights of citizens under federal law.⁶⁵ In fact,
23 the Supreme Court has never ruled a federal adjudicator or quasi-adjudicator who presides over
24 adversarial proceedings to be a mere employee and not an officer subject to the Appointments
25 Clause.

26 ⁶¹ *Id.*, at *12 (citing *United States v. Germaine*, 99 U.S. 508, 511).

27 ⁶² *Id.* (citing *Buckley v. Valeo*, 424 U.S. 1, 126.).

28 ⁶³ See 15 U.S.C.S. §§ 78a *et seq.*; see also FINRA Regulation By-Laws, Art. V, Sections 5.1, 5.3; FINRA Rule 9000 series.

⁶⁴ *Freytag v. Commissioner*, 501 U.S. 868, 881 (1991)

⁶⁵ *Id.*

1 OHO and NAC officers perform the same exact duties as the ALJs and STJs deemed
2 officers by the Supreme Court's precedent. OHO and NAC officers, like ALJs and STJs, "take
3 testimony,' 'conduct trials,' 'rule on the admissibility of evidence,' and 'have the power to enforce
4 compliance with discovery orders.'"⁶⁶ In Newport's case, OHO officers conducted the initial
5 administrative proceeding, which included the filing of the Complaint against Newport along with
6 other respondents. The hearing on the Complaint took place before the OHO hearing panel over
7 nineteen days during November 2015 and January 2016. The hearing included the introduction of
8 documents and other evidence, and testimony from thirty-two witnesses. The OHO hearing officer
9 considered the evidence presented at the hearing and ruled on its admissibility. The OHO
10 deliberated on the evidence and ultimately rendered a decision which it issued on October 17,
11 2016. The OHO officers concluded, just like an ALJ from *Lucia* or STJ in *Freytag*, that Newport
12 had violated numerous federal securities laws and regulations. When Newport appealed the OHO
13 officer's decision, NAC officers reviewed the evidence de novo and issued a final determination.

14 In so doing, OHO and NAC officers exercised "significant discretion,"⁶⁷ and ultimately
15 issued "decisions containing factual findings, legal conclusions, and appropriate remedies," as the
16 Supreme Court held would constitute the role of an officer.⁶⁸ There is simply no meaningful
17 distinction between OHO and NAC officers and the Supreme Court's definition of ALJs and STJs
18 as officers. OHO and NAC officers, like ALJs and STJs, must be constitutionally appointed.

19 Moreover, a NAC officer's authority to issue a final decision goes beyond the authority the
20 Supreme Court held was necessary to establish "significant authority" under the officer standard.⁶⁹
21 OHO officer decisions, while appealable, are final determinations of a citizen or entity's liability
22 under federal securities laws. Regardless of the avenues for appeal, the vital role that these
23 officers play in SEC decision making is substantial. Armed with the duties above, OHO and NAC
24 officers plainly exercise significant authority pursuant to federal law. Their roles mirror those of
25 STJs and ALJs who were held to be officers subject to the Appointments Clause. Accordingly, the

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27 ⁶⁶ *Lucia*, at *4 (quoting *Freytag*, 501 U.S. at 881-82).

28 ⁶⁷ *Freytag*, 501 U.S. at 882.

⁶⁸ *Lucia*, at *4-5.

⁶⁹ See www.finra.org/industry/nac ("Unless FINRA's Board of Governors decides to review the NAC's appellate decision, the NAC's decision represents FINRA's final action."); see also *Freytag*, 501 U.S. at 881 (the Court rejecting the argument that authority to enter a final decision was required to be an officer.).

1 OHO and NAC hearing officers in the Newport matter were required to be properly appointed by
2 the Commission before discharging their duties and improperly expelling Newport.

3 **III. THE OHO AND NAC DECISION IS THE RESULT OF A PROCEDURALLY**
4 **UNFAIRPROCESS IN VIOLATION OF THE EXCHANGE ACT AND FINRA**
5 **RULES**

6 Aside from the fact FINRA’s appointment of OHO and NAC hearing officers runs afoul of
7 the Appointment Clause as shown in *Lucia* with respect to how their positions were created, it also
8 completely eviscerates the intent of the Exchange Act and FINRA rules for “fair and impartial”
9 hearings. Enforcement’s proceedings instituted against Newport were systematically designed to
10 prejudice respondents, like Newport, by FINRA Enforcement controlling every aspect of the
11 process from initiating charges to the NAC Decision. As a result, Newport was denied its due
12 process right to a fair hearing.

13 More specifically, the analysis need not look further than FINRA’s own website page
14 entitled, “About the Office of Hearing Officers.” The page states in pertinent part:

15 “Under Section 15(A)(b)(8) of the Securities and Exchange Act of 1934, FINRA must
16 provide a *fair and impartial* procedure for the disciplining of members, and persons
associated with members, and enforcement of FINRA’s rules.”⁷⁰

17 Interestingly, FINRA adopts and expands the language of the Exchange Act to include “impartial”
18 when describing the type of procedure that a member is automatically afforded as a matter of right
19 under their own rules.⁷¹ To that end, FINRA’s website explains that, “[w]hen the Department of
20 Enforcement determines that misconduct may have occurred, [the Department] may commence a
21 formal disciplinary action by filing a complaint with OHO.”⁷² A hearing officer appointed by
22 FINRA then administers each case for decision by OHO officers, and all appeals of OHO
23 decisions are heard on a de novo basis by NAC officers also appointed by FINRA. In other
24 words, not only does FINRA initiate its own disciplinary proceedings against its members, but it
25 also appoints the officers to hear and decide the same. However, this process clearly does not
26 square with *Lucia* nor does it comport with the Exchange Act or FINRA’s own rule of having a
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28 ⁷⁰ Exchange Act § 15A(b)(8); See Financial Industry Regulatory Authority, About the Hearing Officers (2018), available
at www.finra.org/industry/about-office-hearing-officers [emphasis added].

⁷¹ *Id.*

⁷² *Id.*

1 “fair and impartial” hearing where the entire process is controlled by FINRA.

2 More to point, there is little, if any, independence between FINRA Enforcement, who
3 brings disciplinary actions against FINRA member firms, and the other FINRA staff who decide
4 their merits. FINRA disciplinary hearing framework goes as follows. After a complaint is filed, it
5 then goes to the OHO. The OHO is chaired by a hearing officer, the Chief Hearing Officer, who is
6 an employee of the OHO, which is governed by FINRA. The Chief Hearing Officer appoints a
7 Hearing Panel or an Extended Hearing Panel to conduct the disciplinary proceeding and issue a
8 decision. The Hearing Panel is composed of a Hearing Officer and two panelists. The Hearing
9 Officer along with the two industry panelists, are drawn primarily from a pool of current and
10 former securities industry members of FINRA's District or Regional Committees, as well as its
11 various disciplinary committees, or is a former member of the NAC and the Board of Governor of
12 the FINRA.

13 At the hearing, the parties present evidence for the OHO hearing panel to determine
14 whether a firm or individual has engaged in conduct that violates FINRA rules, SEC regulations or
15 federal securities laws. Once the OHO hearing panel makes a determination, the NAC presides
16 over disciplinary matters appealed to or called for review sua sponte. The NAC also, when
17 requested, in statutory disqualification and membership proceedings; considers the appeals of
18 members seeking exemptive relief and retains the authority to review decisions proposed in other
19 proceedings as set forth in the Code of Procedure. The NAC is composed of a fifteen-member
20 panel, many of which are FINRA staff, which reviews the decision rendered by the OHO hearing
21 panel. If the Board of Governors of FINRA does not call the matter for review, the NAC's
22 decision becomes final.

23 In any other forum, this apparent conflict of interest that exists between FINRA
24 Enforcement and the OHO and NAC officers, who hear and decide these disciplinary proceedings,
25 would not be tolerated. FINRA respondents for years have faced long odds on appeals to the NAC
26 and *Lucia* to a great extent seems to recognize and correct this injustice. FINRA Enforcement
27 appears to have fared well in this captive forum, winning virtually all of their cases in 2017 against
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1 FINRA respondents.⁷³ [FINRA. Org industry decisions for 2017]. Moreover, there are historical
2 findings that support the position that in most cases, the NAC either affirms or increases the
3 sanctions against a FINRA respondent.⁷⁴ [Sutherland Article Litigating Disciplinary Charges
4 Against the SEC and FINRA: It Sometimes Pays]. These results are no doubt a function of how
5 FINRA has manipulated its regulatory scheme to work to its advantage.

6 Newport, like other FINRA respondents before them, was required to defend itself in a
7 forum where the deck was already stacked against them. The NAC Decision is consistent with the
8 fate suffered by Newport's contemporaries in the industry. Some of this can be attributed to
9 FINRA's unilateral appointment of the OHO and NAC officers which violates a "significant
10 structural safeguard of the constitutional scheme."⁷⁵ *Lucia*'s holding that ALJs were required to be
11 appointed to the Commission, those who were appointed by the President of the United States as
12 opposed to the Commission's staffs was likely decided in order to maintain the integrity of both
13 the office and the process. The Framers considered "the power of appointment to officers" to be
14 "the most insidious and powerful weapon . . ."⁷⁶ To prevent the "manipulation of official
15 appointments," *id.*, the Framers "carefully husband[ed] the appointment power" to "limit its
16 diffusion," and to ensure that "all ... officers of the Union, will ... be the choice, though a remote
17 choice, of the people themselves."⁷⁷ While the SEC and other government actors are ultimately
18 accountable to the investing public, FINRA faces no such scrutiny, and its officers risk no removal
19 from office. As a result, there is no direct political accountability to provide an incentive to
20 FINRA officials to ensure that its rules are carried out in a proper and just manner.

21 The appointment of OHO and NAC hearing officers by the Commission would insure that
22 officials who make and receive appointments remain, directly and indirectly, "accountable to
23 political force and the will of the people."⁷⁸ Freytag page 9 of 37. Such a process would further
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25 ⁷³ Financial Industry Regulatory Authority, Monthly and Quarterly Disciplinary Actions (2018), available at
26 www.finra.org/industry/disciplinary-actions.

27 ⁷⁴ Brian L. Rubin and Jae C. Yoon, Litigating Disciplinary Charges Against the SEC and FINRA: It Sometimes Pays (July
28 30, 2012),

<https://us.evershedssutherland.com/portalresource/SutherlandStudyonLitigatingAgainsttheSECandFINRAShowsItSometimesPays.pdf>

⁷⁵ *Edmond v. United States*, 520 U.S. 651 (1997)

⁷⁶ *Freytag v. Commissioner*, 501 U.S. 868, 883 (1991)

⁷⁷ *Id.*

⁷⁸ *Freytag v. Commissioner*, 501 U.S. 868, 884 (1991)

1 insure that FINRA be required to execute the laws under the Exchange Act along with its own in
2 an equitable fashion. Having been subjected to an unconstitutional tribunal, Newport's due
3 process rights under the Exchange Act and FINRA rules were violated.

4 **IV. NEWPORT'S EXPULSION SHOULD BE VACATED BECAUSE IT IS**
5 **UNWARRANTED, EXCESSIVE, OPPRESSIVE AND PUNITIVE EXPULSION OF**
6 **A. NEWPORT IS DISPROPORTIONATELY PUNITIVE**

7 In addition to the due process violations committed by FINRA, the sanction of expulsion
8 imposed against Newport and its affiliated registered representative by the OHO and upheld by NAC,
9 is improper in that it is grossly excessive. The NAC Decision does not sufficiently justify why
10 Newport's expulsion is appropriate in this particular case. Section 19(a)(3) of the Exchange Act
11 "authorizes an order of expulsion not as a penalty, but as a means of protecting investors." Although
12 deterrence may constitute an additional justification for sanctions, "general deterrence is not, by itself,
13 sufficient justification for expulsion . . ."

14 When enforcing members' compliance with applicable rules and regulations, FINRA must
15 provide "a fair procedure for the disciplining of members. . . ." ⁷⁹ The FINRA Sanction Guidelines
16 generally provide that disciplinary sanctions are not intended to be punitive, but sufficiently remedial
17 to deter future misconduct and to improve overall standards in the securities industry. ⁸⁰ The
18 procedure and its results are then reviewed by the Commission. In reviewing the sanction imposed
19 by a SRO upon a member firm, a regulatory agency may "cancel, reduce, or require the remission" of
20 a sanction that "imposes any burden on competition not necessary or appropriate in furtherance of the
21 purposes of [15 U.S.C. §§ 78a et seq.] or is excessive or oppressive. . . ." ⁸¹ As part of the review, the
22 reviewing body "must carefully consider whether there are any aggravating or mitigating factors that
23 are relevant to the agency's determination of an appropriate sanction." ⁸² To uphold the sanction of
24 expulsion, "the Commission must do more than say, in effect, petitioners are bad and must be
25 punished." ⁸³ Accordingly, Newport respectfully requests that the Sanctions be vacated.

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⁷⁹ 15 U.S.C. § 78o-3(b)(8).

28 ⁸⁰ FINRA Sanction Guidelines

⁸¹ 15 U.S.C. § 78s(e)(2); see also *Saad v. SEC* (D.D.C. 2013) 718 F.3d 904, 906.

⁸² *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013).

⁸³ *Blinder, Robinson & Co. v. SEC*, 837 F. 2d 1099, 1113 (D.C. Cir. 1988).

1 Here, the OHO has *failed to identify any remedial* – as opposed to punitive – purpose for the
2 expulsion sanction, despite its clear obligation to do so, where the Court held that the SEC “must
3 explain why imposing the most severe, and therefore apparently punitive sanction is, in fact,
4 remedial, particularly in light of mitigating factors brought to its attention.⁸⁴ In reviewing a
5 disciplinary sanction imposed by FINRA, the Commission must determine whether, with “due regard
6 for the public interest and the protection of investors, that sanction is excessive or oppressive.”⁸⁵ As
7 part of that review, the SEC must carefully consider whether there are any aggravating or mitigating
8 factors that are relevant to the agency’s determination of an appropriate sanction. This review is
9 particularly important when the respondent faces a lifetime bar, which is the securities industry
10 equivalent of capital punishment. One such relevant factor in tailoring sanctions is a firm’s size –
11 most notably in this situation, the number of individuals associated with the firm. Contrary to the
12 NAC’s rationale in its decision, the OHO seems to have singled out Newport, a firm with only a few
13 hundred employees and no significant disciplinary history at the time when it issued its decision.

14 Additionally, the timeline of the punishment clearly demonstrates that it was punitive and not
15 remedial. On August 3, 2016, Newport filed a full withdrawal registration termination request on
16 Form BDW, the Uniform Request for Broker-Dealer Withdrawal. Newport’s license, membership,
17 and registration with FINRA were cancelled on September 6, 2016. On September 30, 2016,
18 Enforcement notified the Office of Hearing Officers that Newport had filed Form BDW and that its
19 membership was cancelled. Six days later, on October 6, 2016, Enforcement notified the OHO that
20 the SEC terminated Newport’s registration. The OHO decision was issued on October 17, 2016.
21 Accordingly, the OHO was aware that Newport was already out of business, yet expelled Newport
22 anyway. There is no remedial purpose for expelling a firm that is already out of business, as the NAC
23 clearly recognized in *CapWest Securities*.⁸⁶ Indeed, a sanction will be overturned on appeal if it lacks
24 reasonableness.⁸⁷ It is unreasonable to expel a firm, with all of the consequences that it entails for
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27 ⁸⁴ *Paz Securities, Inc. et al. v. SEC*, 494 F.3d 1059, 1066 (D.C. Cir. 2007)

28 ⁸⁵ 15 U.S.C. § 78o-3(b)(8).

⁸⁶ *Department of Enforcement v. CapWest Securities, Inc., Lakewood, CO*, Complaint No. 200701058001, dated February 25, 2013, at p. 12, fn. 24.

⁸⁷ *Rooms v. SEC*, 444 F. 3d 1208, 1212 (10th Cir. 2006).

1 other constituents, including customers, employees, and representatives, whose membership has
2 already been terminated.

3 Although the Sanction Guidelines clearly sets out that disciplinary sanctions are not intended
4 to be punitive, there is caselaw that supports they are inapplicable in this case. The sanctions against
5 Newport are unwarranted because Newport is no longer in business and because FINRA cancelled the
6 Firm's membership prior to the issuance of the Sanction. In *Department of Enforcement v. CapWest*
7 *Securities, Inc., Lakewood, CO*, Complaint No. 200701058001, dated February 25, 2013, the NAC
8 acknowledged that the FINRA Guideline recommending expulsion is "inapplicable" where a firm is
9 no longer in business and FINRA has cancelled the firm's membership.⁸⁸ Accordingly, because
10 Newport was no longer in business and because FINRA had cancelled its membership, the expulsion
11 is inappropriate and should be stayed for further review. For these reasons, the OHO's ruling and the
12 NAC Decision should be modified and the sanction of expulsion should be vacated.

13 **B. THE EXPULSION SANCTION IS A SEVERE UNDUE BURDEN ON**
14 **COMPETITION FOR EMPLOYERS OF AFFILIATED OR FORMER**
15 **EMPLOYEES OF NEWPORT**

16 The sanction of expulsion against Newport creates an undue burden on competition because
17 former associated persons of Newport will be subjected to the consequential effects of the punitive
18 expulsion. The Exchange Act provides that: "[t]he rules of the association do not impose any burden
19 on competition not necessary or appropriate in furtherance of the purposes . . ."⁸⁹

20 In the case at bar, as Newport pointed out in its Reply, FINRA's disproportionately severe
21 punishment on Newport, places an undue burden on its former registered representatives and the
22 member firms which they might go to. For example, Firm 2, a firm with no affiliation whatsoever to
23 the conduct at issue, is subject to FINRA Rule 3170 (the Taping Rule) simply because former
24 employees of the firm charged with misconduct (Newport) had previously worked at the former firm.
25 While the true intent behind the Taping Rule is to prevent brokers from moving en masse from a firm
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28 ⁸⁸ *Department of Enforcement v. CapWest Securities, Inc., Lakewood, CO*, Complaint No. 200701058001, dated February 25, 2013, at p. 12, fn. 24.

⁸⁹ Exchange Act § 15A(b)(8)

1 that engaged in unlawful telemarketing practices to a new firm where they might start the illegal
2 activity anew, the rule is inapplicable and unnecessary here.

3 There is no danger that the brokers who moved to Firm 2 would start any “illegal activity
4 anew” because those registered representatives were not engaged in illegal activity at all. Most
5 significantly, the wrongdoers named in the Complaint in question had already been barred from the
6 industry. In addition, there was no evidence before the OHO hearing panel that any Newport
7 associated person, other than the five named brokers, were engaged in any wrongdoing or presented
8 any threat to the investing public. The OHO hearing panel did not make any findings as to any
9 unnamed Newport affiliated persons and there was no finding that the activity at issue, churning and
10 qualitatively and quantitatively unsuitable recommendations, was spread beyond those five brokers
11 who were named in the disciplinary proceedings. The named brokers did not even work at the
12 Newport office, but rather worked from their own respective homes, and thus there was an even
13 lessened chance their transgressions would infiltrate the rest of Firm 2.

14 Employers of affiliates of Newport will suffer an undue burden because compliance with the
15 Taping Rule is expensive to implement and maintain. If any firm, let alone Firm 2, is required to
16 comply with the Taping Rule, they will likely have to hire additional personnel to oversee compliance
17 with the rule, review the tapes, in addition to, incurring the costs of the taping and data storage.
18 Additionally, the undue burden of taping calls would hinder the firm’s ability to retain brokers.
19 Moreover, there would be a tremendous burden on Firm 2’s ability to retain customers and compete
20 for new customers as customers do not want their privacy rights to be compromised by having their
21 calls taped.

22 In turn, these additional burdens on any firm, including Firm 2, would have the inevitable
23 effect of either dissuading the new firm hiring brokers that left Newport searching for employment
24 opportunities or subject them to termination if FINRA requires compliance with the rule after their
25 hire. The imposition of unwarranted excessive supervisory obligations at Firm 2, the anticipated loss
26 of customers by both the registered representatives and Firm 2, and the inability of registered
27 representatives to freely associate with the firm of their choice and their possible termination as a
28 result of the requirements of the Taping Rule, is in clear violation of the language and spirit of the
Exchange Act and FINRA rules.

1 **C. THE SANCTIONS SHOULD BE STAYED ON THE GROUNDS THAT IT**
2 **DISPROPORTIONATELY PUNISHES AFFILIATED REGISTERED**
3 **REPRESENTATIVES**

4 The sanction levied against Newport's has the consequential effect of disproportionately
5 exacting punishment on its former registered representatives which is oppressive. As stated above,
6 "the purpose of expulsion from trading is to protect investors, not to penalize brokers."⁹⁰

7 Indeed, the punitive expulsion of Newport for the conduct of five registered representatives
8 directly impacts scores of other former registered representatives and employees. Former employees
9 of Newport will undoubtedly face prejudice and distrust when seeking further employment or
10 clientele. Now, because of that sanction, those former associated persons once affiliated with
11 Newport have been "marked" as being from an expelled firm. The mark is a significant metric that
12 member firms use for hiring purposes, against which other member firms who hire them are
13 measured, and that customers use to assess registered representatives and member firms. The mark
14 of being from an expelled firm is reported on FINRA's Broker Check, a free tool for the investing
15 public to research the background and experience of financial brokers, advisers, and firms. A red
16 triangle with an exclamation mark is placed next to each firm in an associated person's work history,
17 indicating that an associated person was formerly with a firm that was expelled – regardless of
18 whether the associated person had any involvement in any alleged wrongdoing. Shockingly, an
19 associated person receives the mark even if the associated person did not work at the time the firm at
20 the time it was expelled. This mark stays on the associated person's permanent record for the rest of
21 their careers and can be seen on Broker Check. Accordingly, because of the sanctions, many
22 registered representatives affiliated with Newport have the mark even though they were not found
23 liable for any wrongdoing.

24 As a result, Newport's former registered representative would be penalized by having a
25 demarcation on their Broker Check report as a result of having been associated with Newport. Many
26 of these former registered representatives have no other disclosures on their Broker Check report
27 other than this red triangle with exclamation mark indicating that their prior firm, Newport, was
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⁹⁰ *McCarthy v. S.E.C.*, 406 F. 3d 179, 188 (2nd Cir. 2005).

1 expelled. The mark is a gross mischaracterization of the affiliated person's regulatory record and
2 misleads other member firms, registered representatives, other interested parties and the investing
3 public into believing they were "guilty" of misconduct. Indeed, this permanent disclosure on an
4 innocent registered representative's Broker check report does nothing to protect the investing public,
5 but instead, brings into question their character, associations, business practices, etc. As such, the
6 sanction of Newport's expulsion should be reduced or vacated in order to not punish those who were
7 not affiliated with the conduct at issue by removing the mark from their Broker Check report.

8 **CONCLUSION**

9 For all the foregoing reasons, Newport respectfully submits that the NAC Decision should be
10 reversed, and the sanction imposed against it should be vacated. In the alternative, the case should be
11 remanded for a new hearing before a different panel.

12
13 Respectfully Submitted,

14 Dated: August 27, 2018

15 By: 

16 _____
17 JOHN W. STENSON
18 ALEXIS KING
19 Attorneys for Applicant, Newport Coast
20 Securities, Inc.
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1 **CERTIFICATE OF SERVICE**

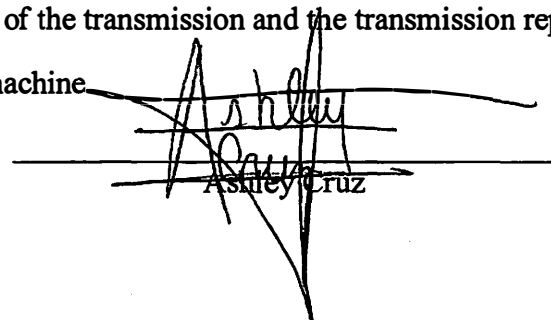
2 Pursuant to Rule 150 and Rule 151 of the Commission's Rules of Practice, I hereby certify
3 that on **August 27, 2018**, I served true and correct copies of the foregoing documents described as
4 the **OPENING BRIEF OF APPLICANT NEWPORT COAST SECURITIES, INC.** on the
5 following parties and persons by placing a true copy thereof enclosed in a sealed envelope
6 addressed as follows:

7 Office of the Secretary [Original and 3 copies]
8 U.S. Securities and Exchange Commission
9 100 F Street, NE
10 Washington, DC 20549-1090
11 Facsimile: (202) 772-9324

Jennifer Brooks, Esq.
Office of General Counsel
FINRA
1735 K Street, NW
Washington, D.C. 20006-1500
Facsimile: (202) 728-8264

12 **BY MAIL:** By placing the document(s) listed above in a sealed envelope with
13 postage thereon fully prepaid, in the United States mail at Los Angeles, California addressed as
14 set forth above. I am readily familiar with the firm's practice of collection and processing of
15 correspondence for mailing. Under that practice, it would be deposited with the U.S. Postal
16 Service on that same day with postage thereon fully prepaid in the ordinary course of business.
17 I am aware that on motion of the party served, service is presumed invalid if the postal
18 cancellation date or postage meter date is more than one day after the date of deposit for mailing
19 in this Declaration.

20 **BY FACSIMILE:** I caused the above-referenced documents(s) to be transmitted
21 to the above-named person(s) at the facsimile telephone number exhibited therewith. The
22 facsimile machine I used complied with California Rules of Court, Rule 200 and the transmission
23 was reported as complete and without error. Pursuant to California Rules of Court, Rule 2006 (d)
24 I caused the machine to print a transmission record of the transmission and the transmission report
25 was properly issued by the transmitting facsimile machine.

26 
27 Ashley Cruz
28