**BEFORE THE**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC**

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In the Matter of the Application of

Newport Coast Securities, Inc.

For Review of Disciplinary Action Taken by

FINRA

File No. 3-18555

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# FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW


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September 27, 2018

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# FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW

## I. INTRODUCTION

This case spotlights profound sales practice violations targeting unsophisticated retail customers and Newport Coast Securities, Inc.'s ("Newport" or the "firm") failure to supervise its sales force. Over the course of at least four years, Newport excessively traded and engaged in securities fraud by churning the accounts of 21 customers. Many of those affected were inexperienced investors and some were at or near retirement age. Newport also recommended qualitatively unsuitable investments in complex exchange-traded products to several of these same unsuspecting retail customers. Newport failed to supervise reasonably the activities of the firm's registered representatives by ignoring over and over for years the glaring red flags that enabled its registered representatives to excessively trade and churn these vulnerable customers' accounts. Newport's abhorrent misconduct enriched the firm and caused real and substantial injury to the affected customers.

FINRA's National Adjudicatory Council ("NAC") found that this was an egregious case with no mitigating factors and several aggravating factors, including a broader pattern of noncompliance illustrated by Newport's prior disciplinary history that includes numerous supervisory violations. The NAC expelled Newport from FINRA membership, in harmony with FINRA's Sanction Guidelines ("Guidelines") and commensurate with the gravity of the firm's extensive misconduct that represented a gross indifference to customers' interests.

Newport abandoned its effort to contest the facts upon which the NAC based its findings of liability against the firm. The Commission's consideration of this case on appeal focuses exclusively on sanctions. Newport has admitted that its misconduct was egregious and that expelling the firm is permissible under the Guidelines.[1] (RP 29890.) Nevertheless, the firm appeals to the Commission to set aside the expulsion as impermissibly punitive.

An abundance of reliable evidence, however, overwhelmingly establishes that Newport manifestly disregarded its supervisory responsibilities and ignored compelling red flags that permitted the excessive trading and churning of its customers' accounts and the recommendations of complex exchange-traded products to retail customers for whom the securities were plainly unsuitable. The firm was well aware of the excessive trading and churning in customer accounts, with annualized turnover rates as high as 151 and cost-to-equity

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[1] "RP" refers to the page numbers in the certified record of this case filed with the Commission on July 6, 2018. "CX" and "RX" refer to exhibits admitted at the FINRA hearing and are part of the certified record.

Throughout its brief, Newport blames FINRA for its imprecise record cites because a "Bates-stamped copy of record was not provided to Applicants" [sic]. FINRA served Newport with a copy of the index to the record as required by the Commission. Newport could have purchased a bates-stamped copy of the record from the copy vendor in order to comply with Commission Rule of Practice 450(b).

ratios as high as 280 percent, yet the firm never restricted the trading in these accounts even after they appeared on exception reports repeatedly. Moreover, the firm permitted the unsuitable, frequent in-and-out trading and concentration of customer accounts in a single security and the use of margin to leverage the accounts of many of its unsophisticated customers.

On appeal, Newport has not presented any legitimate reason to disturb the sanctions that the NAC imposed. In an effort to avoid responsibility, Newport denounces FINRA's disciplinary process as constitutionally unsound, unfair, and otherwise biased. But FINRA's process is evenhanded and fair, and the bases underlying the NAC's findings and sanctions are fully supported and incontrovertible. Newport's misconduct squarely reflects on its ability to comply with regulatory requirements necessary to the proper functioning of the securities industry and protection of the investing public.

Expelling the firm is necessary for the protection of the public interest. Newport failed to recognize its basic obligations as a FINRA member and to deal fairly with its customers by allowing abusive sales practices to flourish while enriching the firm and causing many customers to sustain heavy losses. Newport has put forth no reasonable basis for eliminating the expulsion. Accordingly, FINRA urges the Commission to dismiss the application for review.

## II. BACKGROUND

### A. Newport's Background

Newport was once known as FINRA member, Grant Bettingen, Inc. In June 2008, Rubicon Financial Services purchased Grant Bettingen. In fall 2009, Grant Bettingen changed its name to Newport. (RP 5498-99.)

By the end of 2010, Newport employed approximately 120 to 130 registered persons who worked across the United States. In many instances, a registered representative's home was considered a branch office of the firm. Some registered representatives were supervised by branch managers, while others were overseen by principals located in the firm's main office in Irvine, California. (RP 6373, 6996, CX 212, CX 260, CX 278.)

On August 3, 2016, Newport filed a Uniform Request for Broker-Dealer Withdrawal ("Form BDW"), to terminate its registration with the Commission, all self-regulatory organizations ("SROs"), and all jurisdictions. On September 6, 2016, FINRA cancelled Newport's registration for nonpayment of outstanding fees. The Commission terminated the firm's registration on October 2, 2016. (RP 29467-71, 29477-82.)

**B. Origin of these Proceedings and the Complaint Against Newport and Seven of Its Employees**

This case originated from FINRA's Department of Member Regulation's 2011 sales practice examination of two of Newport's Long Island branch offices. Staff's examination found indications of excessive and unauthorized trading by Newport representatives. A 2012 referral to FINRA's Department of Enforcement ("Enforcement") followed. (RP 7370-71, 7563.) Enforcement's investigation included the review and analysis of voluminous trading data and the taking of on-the-record testimony from several Newport registered representatives. (RP 3523, 26411, CX 626, CX 627, RX 120.)

On July 28, 2014, Enforcement filed a nine-cause complaint that alleged misconduct during the period September 2008 through May 2013. The complaint named Newport and seven individual respondents employed by the firm. Five of these respondents were registered representatives of the firm: Douglas Leone, Andre La Barbera, David Levy, Antonio Costanzo,

and Donald Bartelt.[2] Two of these respondents, Marc Arena and Roman Tyler Luckey, were registered principals of the firm.[3] (RP 7-88.) Arena was Leone's immediate supervisor and Luckey supervised La Barbera, Levy, and Costanzo. (RP 5292-93, 5903, 5936, 6439.)

The causes of action in the complaint as relevant to Newport alleged that: Leone, La Barbera, and Newport, acting through Leone, La Barbera, Levy, Costanzo, and Bartelt, engaged in excessive trading in certain customers' accounts, in violation of NASD Rules 2310 and 2110, NASD IM-2310-2, and FINRA Rules 2111 and 2010 (cause one);[4] Leone, La Barbera, and Newport, acting through Leone, La Barbera, Levy, Costanzo, and Bartelt, churned certain customers' accounts, in willful violation of Securities Exchange Act of 1934 ("Exchange Act") Section 10(b), Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120

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2 Leone entered the securities industry in 1993 as an unregistered cold-caller. (CX 1.) From October 2008 to March 2013, Leone was associated with Newport as a general securities representative and investment banking limited representative. (RP 7964.) Leone worked primarily out of his home and obtained his customers through cold calling and soliciting referrals from existing customers. (RP 2440-41, 2640-41, 2681-82, 2789-90, 3033-34, 3181-08, 3375, 3449-65, 8013-29.)

La Barbera, Levy, and Costanzo formed a partnership in which each had their own customers, but shared commissions and expenses. (RP 5899-5901.) Together, these three general securities representatives moved from firm to firm before becoming associated with Newport in July 2008 and remained there until July or August 2012. (CX 70A, CX 143B, CX 115.) La Barbera worked from his home in New York. The partners obtained customers primarily through cold calling. (RP 10061-79, 5899-5901.)

Bartelt was registered with Newport as a general securities representative and principal and an investment company products and variable contracts limited representative from May 2010 through August 2014. (CX 197A.)

3 Arena and Luckey settled the charges against them. (RP 1497, 2165.) Arena testified at the hearing. (RP 5291-5451, 5504-5638.) Luckey did not testify at the hearing, but he provided an on-the-record interview with FINRA staff that was entered into evidence. (CX 598A.)

4 The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

and 2110 (cause two); La Barbera and Newport, acting through La Barbera, Levy, and Costanzo, recommended that certain customers purchase leveraged or inverse exchange-traded products without reasonably believing that the securities were suitable for these customers, in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010 (cause three); Newport failed to address red flags that its registered representatives were excessively trading and churning customers' accounts, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010 (cause six); and Newport lacked adequate procedures and systems necessary to supervise its registered representatives' sales of structured products and inverse or leveraged exchange-traded products, in violation of NASD Rules 3010(a) and (b) and FINRA Rule 2010 (cause nine). (RP 7-88.)

### C. Newport's Culpability Stems in Part from the Misconduct of the Three Newport Representatives Who Defaulted.

Levy, Costanzo, and Bartelt defaulted (together, the "Defaulting Respondents"). (RP 29573-604.) Newport's liability stems in part from the acts of these Defaulting Respondents. The allegations against the Defaulting Respondents were deemed admitted by the Hearing Officer pursuant to FINRA Rule 9269(a)(2). In addition, the Hearing Officer made findings and conclusions set forth in the default decision that were supported by the extensive evidentiary record compiled during the hearing related to the charges against Newport, Leone, and La Barbera, including the credible testimony of the 10 customers of the Defaulting Respondents. (RP 29531, 29575.)

In the default decision, the Hearing Officer found that the Defaulting Respondents (1) engaged in quantitatively unsuitable trading in the accounts of customers, in violation of NASD Rules 2310 and 2110, FINRA Rules 2111 and 2010, and NASD IM-2310-2; and (2) churned the accounts of customers, in violation of Exchange Act Section 10(b) and Rule 10b-5 thereunder, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2110. The Hearing Officer further

found that Levy and Costanzo made qualitatively unsuitable recommendations of transactions involving leveraged or inverse exchange-traded products to customers, in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010 and that Levy and Costanzo attempted to impede FINRA's disciplinary process, in violation of FINRA Rule 2010. The Hearing Officer barred the Defaulting Respondents, in addition to ordering fines and restitution. (RP 29573-99.)

### D. The Hearing Panel and the NAC Find that Newport and Its Representatives Excessively Traded and Churned Customers' Accounts and Other Egregious Misconduct.

#### 1. Hearing Panel Findings

Respondents Newport, Leone, and La Barbera proceeded to a hearing before a Hearing Panel. The record in this case is robust. The Hearing Panel conducted a hearing over 19 hearing days and heard testimony from more than 30 witnesses, including Leone and eight of his customers, La Barbera and three of his customers, and 10 customers of Levy, Costanzo, and Bartelt in support of the claims against Newport. The Hearing Panel found the testimony of all of the customer witnesses to be "highly credible" and "did not find either Leone or La Barbera to be credible" in any aspect. (RP 29519, 29531-32.)

Most of the customers had limited investment experience and had never actively traded stocks. Most of them opened their Newport accounts based on cold-calls. Most of them identified mischaracterizations and exaggerations of their means and experience in account opening forms that had already been filled out by Newport representatives when they were sent to the customers for signature. Most testified that they were averse to trading on margin. Uniformly, they testified that, contrary to what was shown in the new account forms, they were not interested in aggressive trading and speculation. Uniformly, they also testified that they never rejected any of their brokers' recommendations and that the brokers controlled the trading

in their accounts, much of it done on margin. (RP 29500-08, 29513-16, 29519-29.) And the trading in their accounts was hyperactive, generating costs and charges so high that the customers would have to have realized extraordinary high returns to break even. (RP 29564-66.) The customers' testimony was candid, compelling, consistent, and highly credible. (RP 29531-32.) Virtually all of the customers sustained heavy losses while their brokers and Newport profited from the commissions, mark-ups, and sales charges the customers paid, often unwittingly.

The evidence also overwhelmingly showed that Newport was complicit in its representatives' misconduct through its knowing failure to stop its brokers from excessively trading and churning customers' accounts. The Hearing Panel heard testimony regarding the firm's supervision from Leone's supervisor and branch manager, Arena; Kristopher Kessler, the firm's chief operations officer ("COO"), who had supervisory responsibilities; and Stephen Washburn, who served as the firm's chief compliance officer ("CCO") during much of the relevant period (January 2011 to March 2013). Kessler and Washburn reported directly to the firm's then-current CEO, Kathleen McPherson. (RP 6369, 6392-93.) Their testimony and other supporting evidence show that the firm was aware of its representatives' deceptive use of mark-ups and hyperactive trading. The exorbitantly high turnover rates and cost-to-equity ratios in the highlighted customers' accounts appeared frequently in monthly exception reports. Nonetheless, despite its awareness of these and other red flags signaling churning and unsuitable trading, Newport did nothing to limit or stop the trading. (RP 29543-49.)

The Hearing Panel found that: Newport, Leone, and La Barbera excessively traded and churned 21 customers' accounts; Newport and La Barbera made qualitatively unsuitable recommendations to customers; Leone repeatedly conveyed false account values to a customer

while excessively trading and churning that customer's account; and Newport failed to supervise reasonably Leone, La Barbera, Levy, and Costanzo, who were excessively trading and churning customers' accounts. (RP 29539, 29541, 29550, 29554, 29555.)

The Hearing Panel determined that the violations were closely interrelated and batched sanctions against each respondent. (RP 29558.) The Hearing Panel expelled Newport and fined the firm $1 million; barred Leone and La Barbera in all capacities; fined Leone $400,000; and fined La Barbera $125,000. (RP 29558-60.) The Hearing Panel also ordered that Newport pay $853,617.04 in restitution to customers, with $325,853 of that amount imposed jointly and severally on Leone and $86,940.35 imposed jointly and severally on La Barbera. (RP 29562, 29564-66.)

**2. The NAC Finds that Newport and Its Representatives Excessively Traded and Churned Customers' Accounts Among Other Egregious Misconduct and Expels the Firm.**

Newport, Leone, and La Barbera subsequently appealed to the NAC. (RP 29607-08, 29611-13, 29619-23.) The NAC affirmed the Hearing Panel's findings of liability in totality.[5] (RP 30032.) Newport's sole issue on appeal was the firm's expulsion.[6] (Br. at 5.)

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5 Because the allegations against Newport stem in part from the acts of the Defaulting Respondents, the NAC also reviewed the Hearing Officer's findings that the Defaulting Respondents excessively traded and churned 10 customers' accounts and recommended unsuitable investments. (RP 30052-63, 30077-79, 30081-87.)

6 In its notice of appeal to the NAC, Newport contested the findings of liability and all of the sanctions imposed by the Hearing Panel. (RP 29612.) In its filings on appeal and at oral argument before the subcommittee of the NAC, Newport's counsel revised the firm's issues on appeal, making clear that the firm was no longer contesting liability or any sanctions with the exception of the expulsion. (RP 29788; 29888; 29900; 29982 at 11; 29983 at 16, 17; 29984 at 18.)

Finding that Newport's, Leone's, and La Barbera's violations were egregious and without mitigation, the NAC affirmed the expulsion and bars.[7] (RP 30099.) In expelling Newport, the NAC considered it highly aggravating that Newport abused the trust and confidence of its customers by engaging in a systematic pattern of misconduct that extended for more than four years. Newport was complicit in the excessive trading and churning of 21 customers' accounts—conduct that was well known to the firm. (RP 30109-110.)

The NAC found that the firm acted at least recklessly when it ignored the hyperactive trading that repeatedly appeared on exception reports with annualized turnover rates and cost-to-equity ratios well in excess of permissible benchmarks. Rather than restrict the trading in these accounts and scrutinize the responsible representative, Newport instead permitted the ongoing frequent in-and-out trading and concentration of customer accounts in a single security and the use of margin to leverage the accounts of many of these unsophisticated customers. Newport profited from this trading at the expense of its customers. (RP 30109-110.)

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[7] The NAC modified the fines ordered by the Hearing Panel. The Hearing Panel imposed a unitary fine on each respondent, but without linking the fine amounts to the ranges set forth in the individual Guidelines. The NAC modified this approach by following the individual Guidelines' recommended fine amounts to determine the total fine for each respondent. (RP 30098-99.) The NAC fined Newport $403,000; fined Leone $185,000; and fined La Barbera $125,000. (RP 30101-14.)

The NAC affirmed the Hearing Panel's restitution order in its totality. (RP 30115, 30119-20.) The NAC modified the Hearing Panel's order allowing the respondents' respective fines to be offset by the restitution that each respondent could demonstrate was paid to the customers. (RP 29561.) The NAC eliminated this offset and ordered instead that the respondents satisfy the restitution orders before paying the fines. (RP 30115.) The NAC was correct to order Newport and the individual respondents to recompense the customers' losses through restitution, and to pay fines for the egregious misconduct, sanctions which Newport does not contest on appeal. (Br. at 5.)

The NAC also considered Newport's disciplinary history, which included multiple supervisory violations, as an additional aggravating factor that further supported expelling the firm. (RP 30099-101.) A firm like Newport is a blight on the securities industry. *See, e.g.*, *The Dratel Grp., Inc.*, Exchange Act Release No. 77396, 2016 SEC LEXIS 1035, at *59-71 (Mar. 17, 2016) (affirming expulsion of firm that took advantage of and harmed customers by engaging in egregious fraud). The NAC was right to order Newport's expulsion from FINRA membership.[8]

On June 22, 2018, Newport filed this appeal with the Commission. (RP 30126-28.)

## III. ARGUMENT

The Commission should dismiss Newport's application for review. Newport abandoned any effort to contest the facts upon which the NAC premised its findings that the firm engaged in egregious misconduct that includes excessively trading and churning a score of customers' accounts over the course of at least four years and committing appalling supervisory failures. Newport's liability upon which the NAC based its sanctions is without dispute. Newport merely argues on appeal that the expulsion imposed by the NAC was excessive and that FINRA's disciplinary process was unfair.

Newport provides no relevant or material basis upon which the Commission should modify this sanction, which is abundantly supported by voluminous record evidence. Newport permitted its representatives to engage in a grossly inappropriate level of trading in 21

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[8] Newport is incorrect when it states that the NAC "determined that Newport is statutorily disqualified pursuant to Section 3(a)(39) of the Exchange Act." (Br. at 1.) The NAC does not subject a firm to statutory disqualification as a sanction, and did not do so here when it expelled Newport for its egregious misconduct. *See Anthony A. Grey*, Exchange Act Release No. 75839, 2015 SEC LEXIS 3630, at *47 n.60 (Sept. 3, 2015). Instead, Newport is subject to statutory disqualification by operation of Exchange Act Section 3(a)(39) as a collateral consequence of its expulsion.

customers' accounts in contravention of the suitability obligations placed on firms and representatives. The trading was not only inconsistent with the customers' financial circumstances and investment objectives, but also far exceeded the annualized cost-to-equity percentages and turnover rates that the Commission previously has found indicative of excessive trading. Newport managed these 21 customers' accounts with the purpose of generating commissions while disregarding these customers' interests. Despite the astronomically high levels of trading by the firm's representatives, Newport took no meaningful action to stop or reduce the violative trading. Newport also permitted the sales of exotic exchange-traded products that were conspicuously unsuitable for unsophisticated retail customers.

In an effort to avoid responsibility, Newport denounces FINRA's disciplinary process as constitutionally unsound and otherwise biased, relying on unsupportable and self-serving statements as the basis for much of its arguments while ignoring relevant, well-established federal and Commission precedent that conclusively disposes of its claims. FINRA accorded Newport the fair process that is required under the Exchange Act, and the record reflects no evidence of bias or unfairness. Instead, the NAC carefully considered the voluminous record, including a number of aggravating factors, before ordering Newport's expulsion, which is consistent with the Guidelines for such egregious misconduct undertaken to enrich Newport at the expense of its customers. It was incumbent on the NAC to impose sanctions reasonably designed to prevent Newport, and other similarly situated firms, from repeated unsuitable and fraudulent misconduct that preyed on unsophisticated customers.

Accordingly, the Commission should affirm Newport's expulsion and dismiss the firm's application for review. *See* 15 U.S.C. § 78s(e).[9]

**A. Newport Does Not Dispute the NAC's Findings of Liability.**

On appeal to the Commission, Newport does not contest the NAC's findings that the firm engaged in excessive trading in violation of NASD Rules 2310 and 2110, NASD IM-2310-2, and FINRA Rules 2111 and 2010,[10] and that Newport engaged in churning in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, NASD Rules 2120 and 2110, and FINRA Rules 2020 and 2010.[11] Nor does Newport contest the NAC's findings that it recommended unsuitable securities in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010, and failed to

[9] The standards articulated in Exchange Act Section 19(e) provide that the Commission must dismiss the application for review if it finds that Newport engaged in conduct that violated FINRA rules, FINRA applied its rules in a manner consistent with the purposes of the Exchange Act, and FINRA imposed sanctions that are neither excessive nor oppressive and that do not impose an unnecessary or inappropriate burden on competition. 15 U.S.C. § 78s(e).

[10] NASD Rule 2310(a) provides, "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." FINRA Rule 2111(a) similarly outlines that suitability obligations require FINRA members and representatives to have a reasonable basis to believe that a recommended securities transaction is suitable for the customer, based on the information obtained in order to ascertain the customer's investment profile. NASD IM-2310-2(a)(1) explained that, "[i]mplicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of [FINRA's r]ules, with particular emphasis on the requirement to deal fairly with the public."

[11] Churning is a manipulative and deceptive device within the meaning of Section 10(b) and Rule 10b-5 thereunder. *See Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983); *Michael T. Studer*, 57 S.E.C. 1011, 1020-23 (2004). That same conduct also violates FINRA's antifraud rules (FINRA Rule 2020 and NASD Rule 2120) and just and equitable principles of trade (FINRA Rule 2010 and NASD Rule 2110). *See Fuad Ahmed*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078, at *25 (Sept. 28, 2017); *Dep't of Enforcement v. Davidofsky*, Complaint No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *26 n.27 (FINRA NAC Apr. 26, 2013).

supervise reasonably, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010, four of the firm's representatives who were excessively trading and churning customers' accounts.

For purposes of this brief, FINRA discusses Newport's violations in summary. In the proceedings below, the NAC thoroughly evaluated whether Newport engaged in excessive trading with scienter to constitute churning, recommended qualitatively unsuitable exchange-traded securities to retail customers, and failed to supervise reasonably four of the firm's representatives who were excessively trading and churning customers' accounts. To the extent that the Commission considers these issues as part of this application for review, we direct the Commission to the NAC's in-depth analysis. (RP 30036-87, 30088-96.)

**1. Newport Excessively Traded and Churned Customer Accounts and Failed to Supervise Reasonably.**

Central to the NAC's findings that Newport excessively traded and churned customer accounts was the Hearing Panel's adverse credibility findings in response to hearing Leone's and La Barbera's testimony when compared with their 11 customers' "highly credible" testimony as well as the credible testimony of the 10 customers of the Defaulting Respondents.[12] (RP 30064-66.) The testimony of all customers of the same Newport representative was generally consistent while the Newport representatives' testimony was evasive, inconsistent, implausible, and nonsensical. *See Kenny Akindemowo*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769, at *16 (Sept. 30, 2016) (affirming credibility determinations of witnesses who testified similarly regarding respondent's representations). The NAC properly relied upon those credibility determinations in finding Newport liable. *See William Scholander*, Exchange Act

[12] In finding the Defaulting Respondents' 10 customers credible, the Hearing Panel properly determined that none of the Defaulting Respondents' investigative testimony contradicted or was inconsistent with their customers' hearing testimony or the documentary evidence reflecting the trading in these customers' accounts. (RP 29500-29, 29531-32.)

Release No. 77492, 2016 SEC LEXIS 1209, at *30 n.45 (Mar. 31, 2016) (explaining that credibility determinations "based on hearing the witness's testimony and observing demeanor . . . are entitled to considerable deference"), *aff'd sub nom. Harris v. SEC*, 712 F. App'x 46 (2d Cir. 2017).

Engaging in an appropriate level of trading in a customer's account is a core component of the general suitability obligation placed on member firms and their registered representatives. *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *27; *see John M. Reynolds*, 50 S.E.C. 805, 806 (1991) ("Excessive trading may be thought of as quantitative unsuitability."). Excessive trading occurs when a registered representative has control over the trading in an account and the level of trading in that account is inconsistent with the customer's objectives and financial situation. *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *27. The Commission has explained that "[c]ustomer investment objectives and financial situation are the benchmarks for evaluating whether the level of trading in any account is appropriate." *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *47 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012). None of the trading that occurred in the customers' accounts here was appropriate.

*a. Newport's Representatives Controlled 21 Customers' Accounts.*

Newport does not contest that Leone, La Barbera, and the Defaulting Respondents exercised de facto control over the accounts of the 21 customers. Of these 21 customers, eight were Leone's (Dale Gronewold, Ronald Rushton, James Blair, Christine Perry, Patti Hill, Larry Carrillo, Matthew Jordan, Bentley Stanton), three were La Barbera's (Dan Basgall, Chad Anderson, Roger Grimes), and the remaining 10 were the Defaulting Respondents' (Neil Knauss,

Benjamin Shain, Jim Smith, Robert Sedacca, Douglas Shore, Albert Bishop, Michael Zlotnicki, Marilyn Greene, Leanne Whiting, and Laurence Clawson).[13] (RP 30067-70, 3077.)

Leone's customers testified that he chose the stocks he traded; controlled the timing, volume, and frequency of the trading; and executed most trades without their prior authorization after the initial account opening trades. (RP 2461-66, 2476-79, 2482-84, 2567-70, 2664-75, 2815-16, 2818, 2823-27, 2830-33, 2837-38, 2946-48, 3066-68, 3100-15, 3199-3201, 3204, 3210, 3213, 3218, 3390-92.) Leone also arranged for the eight accounts to be approved for trading on margin and day trading. The customers uniformly testified that they were averse to such methods and that Leone had not discussed these methods ahead of employing them in their accounts. (RP 245-46, 3060-61, 2650, 2676-77, 2745, 2807-09, 2811-12, 2884, 24094, 2933, 3198, 3374-75, 3379, 3404-05.) While the Hearing Panel fully credited the testimony of Leone's customers, it directly rejected Leone's testimony that he spoke with the customers before each trade in their accounts. Leone's testimony was inconsistent on this point and unconvincing when he was questioned about his contacts with the customers. The NAC correctly credited these findings. (RP 30067.)

Like Leone, La Barbera also initiated all of the trading in his three customers' accounts. (RP 5679, 5765-67, 5962, 5965-66.) Basgall, Anderson, and Grimes credibly testified that La Barbera chose the stocks he traded and that he controlled the timing, volume, and frequency of the trading. In addition, La Barbera did not obtain Anderson's prior authorization before executing all of his trades. (RP 4221-22, 4369-70, 5660, 5766, 5962, 5965-66.)

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[13] Newport prohibited discretionary accounts; it is undisputed that none of the registered representatives in this case exercised formal discretionary authority over any of the customer accounts at issue. (RP 6434-35.)

To the extent that La Barbera obtained Anderson's, Basgall's, or Grimes's authorization before making certain trades, La Barbera nonetheless exercised control over the accounts because all of his customers routinely relied upon him and followed his recommendations. (RP 4221-22, 4369-70, 5679, 5765-67, 5663-64, 5673-74, 5695, 5959-60, 30069); *see Ralph Calabro*, Exchange Act Release No. 75076, 2015 SEC LEXIS 2175, at *21 & n.23 (May 29, 2015) (finding de facto control when customer routinely followed broker's recommendations, deferred to broker with respect to the strategy for trading the account, including "selecting securities[] and determining when and in what quantities to trade them[,]" and customer did "not object to them because of his lack of knowledge and expertise"). Further supporting the NAC's finding of de facto control was the fact that none of La Barbera's three customers was an experienced or knowledgeable investor who had a sufficient understanding to evaluate independently La Barbera's recommendations. *See Calabro*, 2015 SEC LEXIS 2175, at *21 & n.23; *see also Cody*, 2011 SEC LEXIS 1862, at *43.

The Defaulting Respondents exercised de facto control over their 10 customers' accounts because the customers relied totally on the Defaulting Respondents when trading in their Newport accounts. The customers' credible testimony supports that these representatives controlled the volume and frequency of transactions in the customers' accounts. The customers consistently followed the Defaulting Respondents' recommendations. All of the customers credibly testified that their representative (either Levy, Costanzo, or Bartelt) selected and purchased each of the securities in their accounts, decided when to purchase and sell the securities, and determined the amount to invest in each security. (RP 4087-4090, 4095-4099 (Knauss); 4262-4263, 4272-4289 (Shain); 5810-5830, 5857-5858, 5884-5887 (Smith); 4699-4704, 4715-4730 (Shore); 4897-4904, 4941-4943 (Sedacca); 4609-4611, 4586-4591 (Bishop);

4975-4981, 4997-4998, 5059-5060 (Zlotnicki); 4809-4814, 4819-4822 (Greene); 3292-3310 (Whiting); 5244-5245, 5267-5269 (Clawson)); *see Calabro*, 2015 SEC LEXIS 2175, at *21 & n.23; *Joseph J. Barbato*, 53 S.E.C. 1259, 1277 (1999).

Several of these customers also testified about unauthorized trading in their accounts. Shain credibly testified that from September 2010 on, Levy traded in Shain's account on his own without obtaining his approval. (RP 4274-83, 4287-89.) Levy exercised de facto control over Shain's account through his unauthorized trading. *See Sandra K. Simpson*, 55 S.E.C. 766, 796 (2002) (explaining that de facto control exists when a customer is incapable of controlling the account because of unauthorized trading); *Olde Discount Corp.*, 53 S.E.C. 803, 831 (1998) ("unauthorized trading presents clear evidence of control"). Bartelt's customers also testified that he bought and sold the securities in their accounts without first speaking with them. (RP 3293, 3295, 3297-98, 3302, 3303, 3306, 3309-10, 5243-47, 4810-14, 4815, 4819, 4822, 4827.) And Bishop credibly testified that the majority of the trading that Costanzo undertook in his account was without Bishop's prior approval. (RP 4589-4594, 4609-4611, 4666-4678); *see Simpson*, 55 S.E.C. at 796. Ample evidence supports that these Newport representatives exercised de facto control.

*b. Newport's Representatives Excessively Traded 21 Customers' Accounts.*

Leone, La Barbera, and the Defaulting Respondents engaged in excessive trading activity that was inconsistent with customers' financial circumstances and investment objectives. These representatives frequently exaggerated on Newport's new account forms their customers' net worth, investing experience, and investment objectives to further their trading. The level of trading in the 21 customers' accounts was grossly inconsistent with the customers' true objectives and financial circumstances, which were much more modest. While the customers

were willing to accept some level of risk, none had any stated investment objective that would support the extraordinary high level of trading that Newport's representatives carried out in the highlighted customers' accounts. The customers generally sought to invest with a minimal amount of risk and had limited prior investment experience. None of these customers sought to invest in high-risk investments, to speculate, to use margin, or to engage in the quantity and pace of the trading done in their accounts. This trading strategy resulted in the costs to Newport's customers "so high as to make the generation of any profit unlikely" and was excessive. *See Clyde J. Bruff*, 53 S.E.C. 880, 885 (1998), *aff'd*, No. 98-71512, 1999 U.S. App. LEXIS 27405 (9th Cir. Oct. 25, 1999).

Newport's representatives' frenetic trading far exceeded the guideposts that the Commission has recognized as indicative of excessive trading. *See Daniel Richard Howard*, 55 S.E.C. 1096, 1098 (2002), *aff'd*, 77 F. App'x 2 (1st Cir. 2003); *Harry Gliksman*, 54 S.E.C. 471, 477 (1999), *aff'd sub nom. Gallagher v. SEC*, 24 F. App'x 702 (9th Cir. 2001). "While there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading, . . . a turnover rate of 6 or a cost-to-equity ratio in excess[] of 20% generally indicates that excessive trading has occurred." *Calabro*, 2015 SEC LEXIS 2175, at *32. For the period each of Leone's eight customers had their accounts open at Newport, the annualized cost to equity percentages ranged from 96 to 280. (RP 24825, 24849, 24929, 24991, 25053, 25085, 25103, 25139.) The annualized turnover rates ranged from 85 to 151. (RP 24825, 24849, 24929, 25053, 25085, 25103, 25139.)

The annualized cost-to-equity ratios and turnover rates for La Barbera's trading in his three customers' accounts ranged from 67 to 142 percent and 16.69 to 39.98 respectively. (RP 25383, 25339, 25397.) For Levy's three customers (Shain, Smith, and Knauss), the annualized

cost-to-equity percentages ranged from 50.7 to 68.82 and the annualized turnover rates ranged from 11.81 to 16.15. (RP 25409, 25425, 25445.) For Costanzo's four customers (Shore, Sedacca, Bishop, and Zlotnicki), the annualized cost-to-equity percentages ranged from 100.02 to 120.71 and the annualized turnover rates ranged from 23.18 to 27.41. (RP 25283, 25295, 25311, 25323.) For the six accounts belonging to Bartelt's three customers (Greene, Whiting, and Clawson), the annualized cost-to-equity percentages ranged from 52.96 to 200.49 and the annualized turnover rates ranged from 18.93 to 72.22. (RP 25477, 25569, 25709, 25883, 25909, 26025.)

The record also reflects "another hallmark of excessive trading" in that Leone's and Bartelt's customers' accounts reflect substantial levels of "in-and-out trading." *See Howard*, 55 S.E.C. at 1100-01. "In-and-out trading" is "the sale of all or part of the securities in an account and reinvestment of the sales proceeds in other securities, followed by the sale of the newly acquired securities." *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *9 n.10. Leone and Bartelt initiated an extraordinary number of trades in the same securities occurring with extraordinary frequency. (RP 24799, 24802, 24805, 24811, 24816, 24819, 24808, 24815; CX 587, 588, 590, 591.)

The evidence abundantly supports the NAC's findings that Newport's five representatives excessively traded 21 customers' accounts in violation of NASD and FINRA rules.

c. *Newport's Representatives Churned 21 Customers' Accounts.*

The NAC further found that the trading engaged in by Newport's five representatives was so excessive that it rose to the level of fraud. "Churning is a shorthand expression for a type of fraudulent conduct in a broker-customer relationship where the broker overtrades a relying

customer's account to generate inflated sales commissions. . . . Churning occurs when a securities broker enters into transactions and manages a client's account for the purpose of generating commissions and in disregard of his client's interests." *Calabro*, 2015 SEC LEXIS 2175, at *3 (internal quotation marks omitted). Scienter in a churning case "may be inferred from the amount of commissions charged by the registered representative." *Id.* at *55-56 (internal quotation marks omitted).

The exceptionally high trading volume, the in-and-out trading, the exorbitant turnover rates, and the sky-high returns that the trading done by Newport's representatives would have needed to generate for the 21 customers to break even evidence the requisite scienter. And for several of these customers, their annual break-even point was more than 150 percent. For example, Leone's customers Gronewold, Carrillo, and Jordan would have had to earn more than 166 percent per year, 174 percent, and 280 percent per year respectively. (RP 24849, 24991, 25053.)

In addition, the 21 customers accounted for the majority of the Newport representatives' commissions during the relevant period. For example, from December 2008 through May 2009, Leone earned from 25 percent to more than 50 percent of his monthly commissions from Gronewold. From February 2009 through June 2009, Leone effected 112 transactions in a single stock with a weighted average holding period of 1.65 days, and for which Gronewold was charged over $11,000. Over the life of his account, Gronewold paid more than $76,000 in costs as a result of Leone's trading. (RP 24799, 24824, 24849.)

Leone's customer, Carrillo, accounted for 39 percent to more than 48 percent of Leone's monthly commissions from December 2010 to April 2011. From October 2010 through April 2011, Leone effected 204 transactions in a single stock with a weighted average holding period

of 5.92 days, and for which Carrillo paid costs of more than $39,000. Carrillo paid more than $67,000 in total costs because of Leone's trading. (CX 543 at 18, CX 544 at 2, CX 549A at 1.)

The evidence is similar for La Barbera's trading, which was in reckless disregard of Basgall's, Anderson's, and Grimes's true investment objectives as evidenced by La Barbera's high volume of trades relative to the size of the accounts and the commissions and other charges. For example, in Basgall's account valued at $63,000, La Barbera made approximately $1.4 million in total purchases and $1.3 million in total sales over the course of approximately 10 months. For this period, the annualized cost-to-equity ratio in Basgall's account was 142.07 percent; the annualized turnover rate was 39.98. (RP 25383.) Basgall paid total costs of $49,712.13, of which $43,685 consisted of undisclosed mark-ups and mark-downs. (CX 561A at 1, CX 137A; RP 25383.) La Barbera traded Basgall's account so actively in October 2011 that this activity accounted for more than 30 percent of La Barbera's total production for the month.[14] (CX-222, at 1-5.)

[14] Similar patterns appear with regard to the trading in Anderson's and Grimes's accounts as well as the customer accounts of the Defaulting Respondents. Anderson invested approximately $57,000 with La Barbera. (RP 5662; CX 131A.) During the 17-month period, La Barbera executed 59 trades, totaling approximately $721,000 in purchases and approximately $667,000 in sales. (RP 25339, 25341.) The annualized turnover rate during this period was 16.69 and the annualized cost-to-equity ratio was 67.23 percent. Total costs were $29,268.90. (RP 5662, 25339.) In Grimes's account, during the period from January 2011 through August 2011, La Barbera made total purchases of more than $173,000 and total sales of approximately $140,000 in an account in which Grimes had deposited $16,851. (RP 25397.) During that period, La Barbera charged mark-ups of $5,496 and commissions of $830. The annualized cost-to-equity ratio during that time was 74.35 percent and the annualized turnover rate was 18.02 percent. (RP 25397.) Levy's customer, Smith, was retired with a modest income, never before had owned any individual stocks or bonds, had no experience using margin or short sales, and testified that he was "not a speculator." Nonetheless, Smith's Newport account authorized the use of margin. Levy utilized margin to fund some of the trading in Smith's account and engaged in short selling. With Smith's $75,000 investment, Levy made over $1.34 million in purchases and $1.32 million in sales over the course of 26 months. Smith paid over $57,800 in costs for this trading. (CX 564A at 1.)

Further evidencing La Barbera's, Levy's, and Costanzo's scienter was the customers' credible testimony that these representatives were charging fees, including mark-ups and mark-downs, that none understood that they were paying at the time. La Barbera, Levy, and Costanzo regularly used high mark-ups on riskless principal trades for customers who were charged commissions on other transactions. For example, La Barbera told Grimes that Newport would not charge anything for his first transaction. (RP 5959-60.) Thereafter, however, La Barbera started charging Grimes mark-ups, which Grimes was unaware he was paying, and La Barbera did not discuss the charges or explain mark-ups or mark-downs to him. (RP 5967, 5970-71.)

La Barbera, along with his partners Levy and Costanzo, also traded using margin to perpetuate their hyperactive trading. Grimes, for example, testified that he had no idea that La Barbera was trading on margin until he later saw an interest charge on an account statement. (RP 5971, 5974, 5976.) La Barbera used margin in order to continue to trade Grimes's and Anderson's accounts when they refused to invest more money with him, which added to these customers' costs. (RP 5655-56, 5971-72.)

Ample evidence supports the NAC's findings that Newport's five representatives churned 21 customers' accounts in violation of the federal securities laws and NASD and FINRA rules.

#### d. *Newport Is Responsible for the Excessive Trading and Churning of Its Representatives and Failed to Supervise Reasonably.*

Newport does not contest that it is directly liable for the excessive trading and churning of its representatives, in violation of the federal securities laws and NASD and FINRA rules, and that it failed to supervise reasonably four of these representatives. The Commission should uphold the NAC's findings.

In holding Newport directly responsible for the excessive trading and churning, the NAC determined that Leone, La Barbera, and the Defaulting Respondents acted as agents of Newport

in connection with their excessive trading and churning. Newport gave Leone, La Barbera, and the Defaulting Respondents actual authority to solicit the highlighted customers in this case, which the firm ratified by establishing new accounts for them and approved them for active trading and the use of margin. (RP 7219-24; *see, e.g.*, CX 12A, 15, 16, 16A, 18, 84A, 88A, 93A, 96, 101A, 104, 107, 108A, 126A, 126B 129A, 135A.) Newport then gave these five representatives actual authority to solicit securities transactions from the customers and empowered these representatives to determine the amount of commissions, mark-ups, or mark-downs to charge for the transactions. (*See, e.g.*, RP 6247, 6473, 6476, 7339.) Newport further ratified the quantitatively unsuitable trading engaged in by the five representatives and the attendant costs charged to the customers by entering those trades and charges in the firm's books and records. "It is well-established that a firm may be held accountable for the misconduct of its associated persons because it is through such persons that a firm acts." *SIG Specialists, Inc.*, Exchange Act Release No. 51867, 2005 SEC LEXIS 1428, at *31 (June 17, 2005); *see, e.g.*, *Prime Investors, Inc.*, 53 S.E.C. 1, 5-6 (1997) (holding firm responsible for misconduct of its employee).

The NAC found a gross dereliction of Newport's supervisory responsibilities when the firm failed to respond to myriad red flags indicative of excessive trading and churning, which permitted the egregious trading to perpetuate.[15] NASD Rule 3010 requires that a member firm

[15] These red flags include the volume of trading in the customers' accounts; the concentration of the accounts in single securities and the use of high levels of margin; in-and-out trading in the accounts; breaking transactions into multiple orders executed within minutes, with multiple fees charged to customers; the total commissions charged on individual accounts relative to total account value; cost-to-equity ratios in excess of 100 percent; turnover rates over 100; certain customers' accounts repeatedly appearing on exception reports; sizable losses in certain customers' accounts; and the use of riskless principal and agency trading in the same

[Footnote continued on next page]

"establish and maintain" a supervisory system "that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules," which "includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." *Studer*, 57 S.E.C. at 1023-24.

Newport was well aware of the violative trading done by these representatives. Newport's management, including the firm's CEO McPherson, COO Kessler, and CCO Washburn, was familiar with the rapid and aggressive trading done by Leone, La Barbera, Levy, and Costanzo, but did nothing to limit or stop them because they were large producers for the firm. (RP 6619, 6634, 6636, 6643-44, 7196, 7261.) Newport also knew that Levy and Costanzo were in a partnership with La Barbera and conducted their business in the same manner with their individual customers. Newport knew that these representatives, along with Leone and Bartlelt, were "some of the firm's most active traders" who "do one thing, they do short-term trading and high risk stocks." (RP 7196.) Newport knew that Leone, La Barbera, Levy, and Costanzo were concentrating their customers' accounts in single securities and using margin in some of these accounts to support the trading. (RP 6463-64.) And despite the customers of these representatives appearing repeatedly on Newport's exception reports reflecting the high volume of trading, commission charges, or both, Newport did nothing to stop or reduce the trading. (CX 433 at 1, 2, 5, 9; 434-440; 545 at 18; 547A at 63; 548A at 42; 549A at 41-43; 550A at 19-22; 551A at 14; 552 at 25; 553 at 98-99; 594A.) Newport moreover had received numerous customer complaints about Leone, La Barbera, Costanzo, and Levy, but did nothing to limit their trading because CEO McPherson forbade it. (RP 6622-25, 6634.)

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account, with the high-cost trades executed on a riskless principal basis and lower-cost trades executed on an agency basis. (RP 30088-89.)

Newport endorsed La Barbera's, Levy's, and Costanzo's use of deceptive mark-ups on purchase transactions while charging commissions on sales; in order for a representative to engage in riskless principal transactions, the firm had to approve it. (RP 6480-81.) Washburn acknowledged that because of the way in which mark-ups and mark-downs appeared on Newport's trade confirmations, an "unsophisticated customer, not aware of the difference between [riskless principal and agency trades] would be paying more for that transaction and not know[] it." (RP 6486.)

Newport deliberately took no action to rein in these representatives. Newport was the direct beneficiary of the excessive trading by receiving all commissions, mark-ups, mark-downs, and other charges that the customers incurred. Newport then rewarded these representatives by paying out a portion of these fees incurred through excessively trading customers' accounts based on their individual agreements with the firm. (RP 3494-95, 5304, 5909.)

The Commission should uphold the NAC's findings that Newport is liable for the excessive trading and churning of its five representatives, in violation of NASD Rules 2310, 2120, and 2110; NASD IM-2310-2; FINRA Rules 2111, 2020, and 2010; and Exchange Act Section 10(b) and Exchange Act Rule 10b-5, and that Newport failed to supervise reasonably the trading of Leone, La Barbera, Levy, and Costanzo, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010.

### 2. Newport Recommended Qualitatively Unsuitable Investments.

Newport does not contest the NAC's findings that the firm, through La Barbera, Levy, and Costanzo, made unsuitable investment recommendations of exchange-traded products to five customers (Dale Rosonke, Basgall, Knauss, Zlotnicki, and Bishop), in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010.[16] The Commission should affirm these findings.

Newport did not conduct a reasonable investigation into the exchange-traded products that La Barbera, Costanzo, and Levy were recommending to their retail customers. *See Dep't of Enforcement v. Brookstone Sec., Inc.*, Complaint No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at *66-67 (FINRA NAC Apr. 16, 2015) (holding firm responsible for unsuitable recommendations of its employees). In determining whether a recommended transaction is qualitatively suitable under NASD Rule 2310, a broker is required to possess an "adequate and reasonable basis for any recommendation that he makes." *See F.J. Kaufman & Co.*, 50 S.E.C. 164, 168 (1989) (internal quotation marks omitted). A broker's recommendations also "must be consistent with his customer's best interests, and he or she must abstain from making recommendations that are inconsistent with the customer's financial situation." *Dane S. Faber*, 57 S.E.C. 297, 310 (2004).

From March 2009 through August 2010, La Barbera recommended to Rosonke approximately 26 purchases of seven leveraged or inverse exchange-traded funds ("ETFs"). (CX 592, at 1-2, RP 16799; 17780, 17788, 17923.) From March 2010 through September 2010, Costanzo recommended four purchases of three ETFs in Zlotnicki's account. (CX 592 at 1.)

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[16] Newport also excessively traded and churned four of these customer's accounts (Basgall, Knauss, Zlotnicki, and Bishop).

La Barbera and his partners Costanzo and Levy also recommended purchases of iPath S&P 500 VIX Short Term Futures Exchange Traded Notes ("VXX"), a highly complex futures index linked exchange-traded note that is intended for highly sophisticated investors with specialized investment needs, to three unsophisticated customers. (CX 347.) Costanzo in June 2010 recommended one purchase of VXX to Zlotnicki and one purchase of VXX to Bishop in February 2012. (CX 593.) La Barbera, between December 2011 and February 2012, recommended three purchases of VXX to Basgall. And Levy, in February 2012, recommended one purchase of VXX to Knauss. (CX 593.)

The NAC found no evidence that La Barbera, Costanzo, or Levy performed a reasonable basis suitability analysis of the ETFs or the VXX that they were recommending to retail investors. For example, La Barbera exhibited no understanding of the ETFs that he traded in Rosonke's account and could not adequately explain why they were specifically suitable for him. (RP 6169-71.) Nor could La Barbera recall the specifics of his recommendation "other than during that period of time it was heavily recommended, not only by myself but throughout the industry." La Barbera admitted that he was recommending leveraged and inverse ETFs during a volatile market. (RP 6170-73.)

The complexity and riskiness of these products are reflected in the disclosures contained in the ETFs' registration statements. (CX-333, at 139-40, 151, 254-65, 301-14 (FAS, ERX, FAZ, TZA); CX-342, at 104-05, 112-13 (SKF and SRS); CX-344 at 29 (UCO).) These ETFs reset daily, were not suitable for retail investors to hold for more than one trading session—particularly in volatile markets—and were intended to be used by highly sophisticated investors. Nonetheless, these ETFs purchased by Newport's customers often were held for longer than one day thereby presenting substantial risk and were unsuitable for unsophisticated retail investors

like them. (CX 592); *see FINRA Regulatory Notice 09-31*, 2009 FINRA LEXIS 94, at *1 (June 2009).

Costanzo's and Levy's recommended purchases of the exchange-traded products were equally unsuitable for their customers. Costanzo admitted that his sales of VXX were unsuitable, that he did not understand these products when he recommended them, and that they were not appropriate for retail customers. (RP 26330, 26332.) In addition, Zlotonicki, who was an 81-year-old retired teacher with an income of approximately [redacted] per month from social security and a pension, testified that Costanzo never explained the risks and features of any of the ETFs or VXX that he bought and sold in his account. (RP 4944, 4976, 4987, 4992.) Despite the risks of holding the ETFs for longer than one day, Zlotnicki's account frequently held the ETFs for several weeks. (CX 592.) The recommended purchases of VXX in Bishop's and Knauss's accounts were similarly unsuitable in that the VXX positions were held for long periods and the risks were not explained to the customers. (CX 592.) Bishop, who was a retired engineer, testified that neither Costanzo nor anyone from Newport informed him of the risks of VXX. (RP 4615.) Knauss testified similarly that Levy did not discuss the risks of VXX and that he "knew very little about it." (RP 4111-14.)

Newport's CCO, Washburn, played a central role in the sales of these complex products. Washburn testified that the firm placed no restrictions on its representatives' sale of ETFs until April 18, 2011. (RP 6599-6602.) And even then, Newport permitted the sales of ETFs and VXX to recur. (RP 4139-40.) Washburn required representatives selling ETFs to come to him for approval of these transactions. Washburn generated new suitability parameters for ETF purchases, but they were not followed. These included selling to "accredited investors only" and limiting the concentration of ETFs to no more than 10 percent of a customer's investment

portfolio. (RP 6795-99.) Despite these purported limitations, Newport permitted the sales that occurred in this case, including concentrating 70 percent of Basgall's account equity in VXX. Basgall, was near retirement, had limited income and little investing experience, and was not an accredited investor. He had a moderate risk tolerance and did not seek high-risk investments. (RP 4213-14, 4182-83, 4187.) Washburn admitted that the VXX "is so complex in nature that it is really hard to determine the underlying positions" and that his lack of understanding of the product likely impaired his ability to make appropriate suitability decisions about it. (RP 6615-16, 6803-05.)

The Commission should uphold the NAC's findings that Newport made qualitatively unsuitable investment recommendations in violation of NASD and FINRA Rules.

* * * *

The record provides ample evidentiary support for the NAC's liability findings, and Newport's application for review points to nothing to undo those findings. The Commission should sustain the NAC's findings in their totality.

**B. Expelling Newport for Its Egregious Misconduct Is Appropriate and Neither Excessive Nor Oppressive.**

After a comprehensive review of the facts, the law, and numerous aggravating factors present, including Newport's disciplinary history, the NAC, consistent with FINRA's Guidelines, expelled Newport for engaging in unsuitable and excessive trading, churning, and failing to supervise its representatives. Unsuitable and excessive trading and churning are extremely serious and patently antithetical to a broker-dealer's duties and obligations to its customers and warrant the gravest sanctions. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *97 (July 2, 2013); *Alvin W. Gebhart, Jr.*, 58 S.E.C. 1133, 1177 (2006) ("Conduct that violate[s] the antifraud provisions of the federal securities laws is

especially serious and subject to the severest of sanctions . . . ."), *aff'd in relevant part*, 255 F. App'x 254 (9th Cir. 2007). Furthermore, "[p]roper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and [FINRA] rules." *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225, at *35 (Sept. 16, 2011). An expulsion is appropriate when, as in this case, regulatory failures are so serious that a stringent sanction is needed to protect investors from a firm that has shown itself unfit to participate in the securities industry. *See Dratel*, 2016 SEC LEXIS 1035, at *71.

Newport protests that FINRA's action is excessive, but no fact or argument exists that serves to mitigate the expulsion that FINRA imposed for Newport's egregious misconduct— a level of misconduct to which Newport accedes.[17] (Br. at 15; RP 29890.) The record fully supports this conclusion. The expulsion is not excessive or oppressive, and should be sustained.[18]

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[17] While Newport states in its brief that the expulsion should be stayed (Br. at 19), it is apparent from the contents of its brief that it is not making a motion for stay, but arguing that the expulsion be reduced or eliminated. (Br. at 20 ("the sanction of Newport's expulsion should be reduced or vacated").) Even if the Commission were to construe this statement as a motion for stay, which it should not, Newport has not met the high standard required for a stay, and the Commission should deny it. *See Meyers Assocs. L.P.*, Exchange Act Release No. 77994, 2016 SEC LEXIS 1999, at *8-20 (June 3, 2016).

[18] In arguing that the expulsion is excessive, Newport points to purported errors of the Hearing Panel, including for failing to identify a remedial purpose of the sanction and consider Newport's size. (Br. 15-16.) The NAC's decision is the final action of FINRA; thus, the Commission reviews the NAC's decision—not the Hearing Panel's. *See* 15 U.S.C. § 78s(e); FINRA Rules 9351(e), 9370(a). The NAC thoroughly considered both of these factors when expelling the firm. (RP 30110, 30113-14.) Newport also contends that it had "no significant disciplinary history" when the Hearing Panel issued its decision in October 2016. (Br. at 16.) Newport is flat wrong. As the NAC found, Newport has an extensive history of wide-ranging supervisory failures dating back to 2007. (RP 30100.) Regardless, any findings of the Hearing Panel that are contrary to the NAC's findings are irrelevant. *See Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 SEC LEXIS 2631, at *21 n.17 (Nov. 8, 2006).

### 1. The Guidelines Support Expelling Newport.

In evaluating what sanctions to impose, the NAC determined that the egregious violations in this case were closely interrelated and imposed a single set of sanctions, which included expelling Newport. The NAC considered the Guidelines for excessive trading, churning, qualitatively unsuitable trading, and supervisory failures.[19] (RP 30101-03, 30108.) The Guidelines for excessive trading and churning recommend a fine of $5,000 to $110,000, and a suspension in any or all capacities for one month to two years. *FINRA Sanction Guidelines* 78 (2017). When aggravating factors predominate as they do in this case, the Guidelines recommend a longer suspension or expulsion. *Id.* The Guidelines for making unsuitable recommendations recommend a fine of $2,500 to $110,000. *Id.* at 95. They further recommend in egregious cases, a suspension of any or all activities for longer than 90 days or an expulsion. *Id.* For systemic supervisory failures like those seen here occurring over an extended period of time, the Guidelines recommend fining a firm $10,000 to $292,000. *Id.* at 105. When aggravating factors predominate, an adjudicator is directed to consider a higher fine and suspending the firm with respect to any or all relevant activities or functions for 10 business days to two years or expelling the firm. *Id.* at 106. The NAC also considered the violation-specific considerations applicable to failures to supervise and systemic supervisory failures and the General Principles and Principal Considerations relevant to all sanction determinations. (RP 30099 & n.61, 30109-10.) Expelling Newport is within the parameters of the Guidelines and consistent with its recommendations.

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[19] The Commission in its review of sanctions gives weight to whether the sanctions are within the allowable sanction range under the Guidelines. *See Steven Grivas*, Exchange Act Release No. 77470, 2016 SEC LEXIS 1173, at *25 n.37 (Mar. 29, 2016).

Numerous aggravating factors accompanied Newport's violations. At the outset, the NAC found that Newport's disciplinary history aggravated its misconduct and reflected a disregard of regulatory obligations. (RP 30099-30101); *Guidelines*, at 2 ("Disciplinary sanctions should be more severe for recidivists"—particularly in cases where "past misconduct [is] similar to that at issue" or "evidences a reckless disregard for regulatory requirements, investor protection, or market integrity."). Newport's disciplinary history includes myriad supervisory lapses among other violations spanning approximately eight years. (RP 30100; CX 542.) As the NAC correctly determined, Newport's history is further evidence that the firm poses a risk to the investing public. *See Joseph Ricupero*, Exchange Act Release No. 62891, 2010 SEC LEXIS 2988, at *24 (Sept. 10, 2010), *aff'd*, 436 F. App'x 31 (2d Cir. 2011).

The NAC considered that it was highly aggravating that Newport abused the trust and confidence of its customers by engaging in a systematic pattern of misconduct that extended for more than four years. (RP 30109); *Guidelines*, at 7 (Principal Considerations Nos. 8 & 9), 105. Newport was complicit in the excessive trading and churning of 21 customers' accounts. *Guidelines*, at 7 (Principal Considerations No. 8). Generally these were unsophisticated customers, some of whom were at or near retirement age, and the firm permitted the frequent concentration of customer accounts in a single security and the use of margin to leverage the accounts of many of these customers. (RP 30109); *Guidelines*, at 8 (Principal Considerations No. 18), 105-06. Newport also knowingly permitted La Barbera, Levy, and Costanzo to use riskless principal and agency trading in the same account, with high-cost trades executed on a riskless principal basis charging the customers a mark-up or mark-down, which these inexperienced customers did not understand. As the customers' uniformly testified, they did not know what they were being charged, nor did they understand the astronomical costs of the

trading. Many thought they only paid for trades that were profitable because that is what their Newport representative told them, which was patently false.

The firm also permitted La Barbera, Levy, and Costanzo to make unsuitable recommendations of exchange-traded products to unsuspecting retail customers, several of whom were simultaneous victims of Newport's excessive trading and churning. Newport catapulted its own interest in commissions and fees over the interests of its customers. Not surprisingly, Newport's misconduct inflicted devastating injuries on the customers, while the firm profited from this trading. (RP 30109); *Guidelines*, at 7-8 (Principal Considerations No. 11 & 16).

The NAC correctly concluded that Newport was well aware of the hyperactive trading of its representatives and was at least reckless in permitting it. (RP 30109-10); *see id.* at 8 (Principal Considerations No. 13). Leone, for example, engaged in frequent in-and-out trading and had a practice of breaking transactions into multiple orders executed within minutes of each other thereby charging multiple commissions and firm activity fees for the trades. Leone's customer accounts had annualized turnover rates as high as 151 and cost-to-equity ratios as high as 280 percent, yet the firm never restricted Leone's trading in these accounts even after they appeared on exception reports repeatedly. *See id.* at 105-06.

Newport manifestly disregarded its supervisory responsibilities and ignored compelling red flags, which permitted its representatives to engage in blatantly abusive sales practices. *See id.* Taking advantage of its customers' lack of investing sophistication, Newport permitted its representatives to engage in risky and excessive trading that the firm must have known was inappropriate for these customers. Contrary to its regulatory mandate, Newport never critically questioned the sky-high trade activity, commissions, and mark-ups in the customers' accounts,

despite the amount of total commissions or mark-ups charged relative to the total account value. Newport readily approved customers' new account documentation that encouraged these representatives to use margin to support their trading without probing whether such trading was suitable for customers. Newport, despite its awareness of the many red flags, did not limit the trading of any of these representatives because the firm profited from their misconduct.

Based upon all of the forgoing, the NAC properly concluded that Newport's egregious misconduct made it a danger to the investing public and that expulsion of the firm was the only effective remedy. The Commission should affirm the expulsion to protect investors, and this sanction is neither excessive nor oppressive considering the nature of, and circumstances surrounding, Newport's egregious misconduct.

### 2. Newport Fails to Demonstrate Mitigating Factors.

Newport argues that because it left the industry when it filed a Form BDW, the expulsion of the firm is punitive. (Br. at 2, 6.) Newport's assertion has no effect on the NAC's sanction other than to highlight that Newport fails to recognize the wrongful nature of its misconduct.[20]

Notwithstanding the numerous and obvious warning signs of sales practice violations, including an awareness of the aggressive and rapid trading style of Leone, La Barbera, Levy, and Costanzo, Newport permitted the churning of these representatives' customer accounts to continue for years without taking any reasonable steps to curb the unsuitable and excessive trading. Unless Newport is expelled, there is no guarantee that the firm will not seek to return to the securities industry at some point in the future. *See Calabro*, 2015 SEC LEXIS 2175, at *164

[20] In a similar effort to shift responsibility, Newport seeks to narrow the focus of its wrongdoing by emphasizing that FINRA found only five of its representatives engaged in misconduct. (Br. at 19.) Newport misses the point and does not recognize that its *own* misconduct, including glaring supervisory failures, had catastrophic consequences to 21 customers over the course of more than four years.

("Absent a bar, nothing would prevent Calabro from reentering the industry.") Given Newport's unsuitable and excessive trading, churning, and its systemic supervisory failures that permitted the firm to profit at the expense of numerous customers, Newport's participation in the industry would present a risk of future violations. *See id.* *164-65. "The securities industry presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence." *Id.* at 166 (internal quotation marks omitted). Because of the unlimited opportunities for abuses at customers' expense, the sanction is not punitive, but will in fact deter Newport and similarly situated firms from engaging in egregious sales practice violations and ignoring their obligation to exercise reasonable supervision. *See PAZ Sec., Inc. v. SEC*, 566 F.3d 1172, 1175-76 (D.C. Cir. 2009) (upholding the "findings regarding the protective interests to be served" by firm's expulsion); *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005) ("Although general deterrence is not, by itself, sufficient justification for expulsion or suspension, we recognize that it may be considered as part of the overall remedial inquiry.").

Newport argues that the expulsion "should be vacated" because the NAC previously did not expel a firm that was out of business in *Dep't of Enforcement v. CapWest Sec., Inc.*, Complaint No. 2007010158001, 2013 FINRA Discip. LEXIS 4, at *30 n.24 (FINRA NAC Feb. 25, 2013), *aff'd*, Exchange Act Release No. 31340, 2014 SEC LEXIS 205 (Jan. 17, 2014). (Br. at 16-17.) Newport's reliance on *CapWest* is misplaced. "[T]he appropriateness of a sanction depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken in other proceedings." *Murphy*, 2013 SEC LEXIS 1933, at *115-16. As the NAC explained when it expelled Newport, unlike the misconduct in *CapWest*, Newport's misconduct was egregious, without mitigation, and caused widespread

harm to many unsophisticated and vulnerable customers, which directly resulted in financial gain to the firm. (RP 30114.)

Moreover, in *CapWest*, the NAC did *not* address whether ordering the expulsion of a firm that is no longer in business may nonetheless serve a remedial purpose. Whereas in this case, the NAC explained that the characteristics of Newport's misconduct were central to the remedial justification of the expulsion. (RP 30114.) Newport's systemic supervisory failures are at the heart of the firm's rule violations and a troubling indication that the firm holds its regulatory obligations in contempt. "Because proper supervision serves such an important role in protecting investors, egregious violations of supervisory rules often warrant the most severe sanctions." *Murphy*, 2013 SEC LEXIS 1933, at *112. The expulsion is necessary in this case because it serves the remedial purpose of protecting investors who may be harmed by similar misconduct in the future if the firm was eligible for membership and deterring other firms from engaging in similar misconduct.

Newport has demonstrated no mitigation. Given the nature of Newport's misconduct, which involved, among other things, the repeated fraudulent self-dealing at the expense of its customers in the form of churning, an expulsion is appropriate and not excessive or oppressive.

## IV. Newport's Other Arguments Are Without Merit and Do Not Undermine the Expulsion.

### A. The Supreme Court's Decision in *Lucia* Does Not Apply to FINRA's Disciplinary Process.

The keystone of Newport's appeal is its erroneous assertion that FINRA's expulsion of Newport is "void" because FINRA's adjudicators were not appointed by the President, a federal court, or government department head, in violation of the Appointments Clause and, by

extension, the Supreme Court's decision in *Lucia v. SEC*, 138 S. Ct. 2044 (2018). Newport's argument crumbles under the weight of established precedent.

It is well settled that "self-regulatory organizations, such as FINRA, are not Government-created, Government-appointed entit[ies] and therefore do not unlawfully usurp power reserved to the executive branch." *Manuel P. Asensio*, Exchange Act Release No. 62645, 2010 SEC LEXIS 2521, at *6-7 (Aug. 4, 2010) (internal quotation marks omitted). Moreover, FINRA's role as an SRO is not a traditional or exclusive function of the government. Rather, FINRA is incorporated as a private corporation and composed entirely of private-sector securities firms located throughout the United States. FINRA does not receive federal or state funding, and government officials do not appoint its members or serve on FINRA's Board or committees, including the NAC. *See D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 162 (2d Cir. 2002). The Appointments Clause and the Supreme Court's holding in *Lucia* plainly do not apply to FINRA.

As the Commission has explained in a prior case similarly challenging FINRA's disciplinary process under the Appointments Clause, "FINRA is not exercising federal executive power." *Asensio*, 2010 SEC LEXIS 2521, at *6. Instead, "FINRA is registered under, and operates subject to, Section 15A of the Exchange Act." *Id.* The Supreme Court noted in *United States v. NASD*, 422 U.S. 694, 700 n.6 (1975), that Section 15A, "supplements the [SEC's] regulation of the over-the-counter markets by providing a system of cooperative self-regulation through voluntary associations of brokers and dealers." Section 15A expressly "authorizes [SROs] to promulgate rules designed to prevent fraudulent and manipulative practices; to promote equitable principles of trade; to safeguard against unreasonable profits and charges; and generally to protect investors and the public interest," which are many of the rules that Newport

violated at the expense of investors in this case. *See id.* And although Section 15A authorizes the Commission to exercise a "significant oversight function" over the rules and activities of FINRA, the Commission's oversight does not convert FINRA's actions into state actions mandating constitutional protections. *See Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 484-85 (2010) (contrasting "expansive powers" granted to the PCAOB with the more limited powers granted to SROs); *San Francisco Arts & Ath. v. United States Olympic Comm.*, 483 U.S. 522, 544 (1987) ("Even extensive regulation by the government does not transform the actions of the regulated entity into those of the government.").

Indeed, multiple federal courts and the Commission have held repeatedly that constitutional protections are inapplicable to FINRA proceedings. *See, e.g., D.L. Cromwell*, 279 F.3d at 162 (stating that it is a well-settled principle that FINRA's predecessor, NASD, is not a governmental actor); *Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999) (finding that NASD is not a state actor, and constitutional requirements generally do not apply to it); *Michael Earl McCune*, Exchange Act Release No. 77375, 2016 SEC LEXIS 1026, at *37 n.52 (Mar. 15, 2016) ("Because FINRA is not a state actor and is not subject to constitutional requirements, it could not have violated McCune's due process rights."), *aff'd*, 672 F. App'x 865 (10th Cir. 2016); *William J. Gallagher*, 56 S.E.C. 163, 168 n.10 (2003) ("[W]e note that many courts and this Commission have determined that self-regulatory organizations . . . are not subject to . . . constitutional limitations applicable to government agencies."). The Commission should reject Newport's unsupported attempt to undermine FINRA's sound adjudicatory process.

### B. The Proceedings Against Newport Were Fair.

Newport pursued its defense in this case before two independent adjudicators: a properly constituted Hearing Panel and the NAC. Yet Newport claims on appeal that FINRA's proceedings were unfair, Enforcement controll[ed] "every aspect of the process," and the firm was denied "its due process right to a fair hearing" because of a purported lack of independence among Enforcement, the Hearing Officer, and the NAC.[21] (Br. at 12-15.) The record reflects that Newport was accorded the fair process demanded by FINRA rules and the Exchange Act. *See Akindemowo*, 2016 SEC LEXIS 3769, at *33 & n.34 (rejecting fairness argument that FINRA acted as "the judge, the prosecutor and the jury"). Moreover, FINRA's separation of functions in its disciplinary process has been approved by the Commission as fair and was followed. *See id.* (citing FINRA Rule 9144 (Separation of Functions); *Self-Regulatory Organizations*, Exchange Act Release No. 58643, 73 Fed. Reg. 57174 (Oct. 1, 2008); *Self-Regulatory Organizations*, Exchange Act Release No. 38909, 1997 SEC LEXIS 1624 (Aug. 7, 1997)).

The record reflects that FINRA followed its rules in this case without a single instance of improper influence by Enforcement staff. The Hearing Panelists' appointments were consistent with FINRA rules. *See* FINRA Rules 9213, 9231, 9232. Soon after Enforcement filed its complaint, the Deputy Chief Hearing Officer assigned a Hearing Officer to preside over this case

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[21] As discussed in Part IV.A, FINRA is not a state actor and thus not subject to the Constitution's due process requirements. *See, e.g., Meyers Assocs. L.P.*, Exchange Act Release No. 81778, 2017 SEC LEXIS 3096, at *26 n.37 (Sept. 29, 2017) ("Because FINRA is not a state actor, the requirements of constitutional due process do not apply."); *Timothy P. Pedregon*, Exchange Act Release No. 61791, 2010 SEC LEXIS 1164, at *19 n.19 (Mar. 26, 2010) ("It is well established that the requirements of constitutional due process do not apply to FINRA because FINRA is not a state actor."); *Mark H. Love*, 57 S.E.C. 315, 322 n.13 (2004) ("We have held that NASD proceedings are not state actions and thus not subject to constitutional requirements.").

and subsequently appointed a replacement Hearing Officer. *See* FINRA Rule 9213(a); (RP 183, 1405). The Chief Hearing Officer thereafter appointed the Hearing Panelists pursuant to FINRA Rules 9231 and 9232. *See* FINRA Rule 9213(b); (RP 1631-32).

Newport was afforded the opportunity to file a motion to object to the Hearing Officer's and Hearing Panelists' participation in the hearing, but the firm failed to do so. Newport, accordingly, has waived any argument that it may have concerning the makeup of the panel. FINRA rules provide that a party, having a "reasonable, good faith belief" that a conflict of interest or bias exists, may file a motion to disqualify a Hearing Officer or Hearing Panelist no later than 15 days after learning of the facts on which the claim is based. FINRA Rules 9233(b), 9234(b). Newport claims, without any specific details, that the unfairness was evident in "every aspect of the process." (Br. at 12.) It was therefore incumbent on Newport to raise the issue of unfairness before now. *See Akindemowo*, 2016 SEC LEXIS 3769, at *34 n.35. Newport, however, affirmatively chose to proceed with the hearing before the Hearing Panel without making any such motions and belatedly raised its objection in this appeal. Newport has forfeited its right to object to the Hearing Officer's or Hearing Panel's participation in the proceedings below.[22] *See* FINRA Rules 9233(b), 9234(b); *see Akindemowo*, 2016 SEC LEXIS 3769, at *34 n.35.

Furthermore, Newport's unsubstantiated assertions of bias are an insufficient basis to invalidate FINRA's proceedings. (Br. at 1, 9.) Newport is basing its claims of unfairness on the Hearing Panel and the NAC ruling against it "in a forum where the deck was already stacked

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[22] Newport likewise did not object to the participation of the NAC subcommittee empaneled to hear Newport's appeal. Contrary to Newport's assertion, the NAC is not comprised of any FINRA staff. (Br. at 13) The NAC consists of 15 members, seven industry members and eight non-industry members, who are selected in accordance with FINRA By-Laws. Art. V & VI of FINRA Regulation By-Laws.

against" it. (Br. at 14.) Adverse rulings, without more, do not evidence bias. *Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *62 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010). "[B]ias by a[n adjudicator] is disqualifying only when it stems from an extrajudicial source and results in a decision on the merits based on matters other than those gleaned from participation in a case." *See id.* In this case, the evidence demonstrates that the Hearing Panel and the NAC formulated their opinions based on the robust record and imposed liability and sanctions against Newport based on that overwhelming evidence. The record provides no support for Newport's argument that the Hearing Panel or the NAC was biased against it and had predetermined the outcome of the case as it suggests.[23]

Newport received the "fair procedure" that the Exchange Act requires here, including notice of the specific charges against it and multiple opportunities to be heard. *See* 15 U.S.C. § 78o-3(b)(8), (h)(1) (requiring that self-regulatory organizations provide fair procedures); *Sundra Escott-Russell*, 54 S.E.C. 867, 873-74 (2000) (finding requirements of the Exchange Act met when FINRA brought specific charges, the respondent had notice of such charges, the respondent had an opportunity to defend against such charges, and FINRA kept a record of the proceedings). Newport had the opportunity to advocate for itself and counsel represented the firm throughout these proceedings. The Hearing Officer permitted Newport to include exhibits in the record and was accorded the right to offer testimony on its own behalf and to cross-examine witnesses at the hearing. The record indicates that the Hearing Panel was fair and provided Newport with the fair process demanded by the Exchange Act.

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[23] Newport's misplaced reliance on an article summarizing the sanctions in other cases provides no evidence of bias in FINRA's disciplinary proceedings and merely reflects statistical information. (Br. at 14.)

The Commission should reject Newport's unsubstantiated assertions of bias and unfairness.

**C. The Expulsion Does Not Impose an Undue Burden on Competition.**

Newport argues that an expulsion imposes an undue burden on competition because former Newport representatives will face "prejudice and distrust" from potential employers and customers related to the firm's expulsion being reported on BrokerCheck. (Br. at 2, 17-20.) This argument is baseless. First, any collateral consequence that may befall Newport's former associated persons from the expulsion is not relevant to whether the expulsion was appropriate in light of *Newport's* egregious misconduct. Moreover, the publication of Newport's expulsion on BrokerCheck is not a disciplinary action or sanction that is subject to Commission review. *Eric David Wanger*, Exchange Act Release No. 79008, 2016 SEC LEXIS 3770, at *12 (Sept. 30, 2016).

Second, FINRA knows of no case in which the Commission has vacated a sanction because it imposed an undue burden on competition to persons or firms who were not parties to the disciplinary action or subject to a sanction. Rather, the Commission previously has rejected similar arguments made by parties in favor of the public interest protections that outweigh any undue burden from SRO action. *See, e.g.*, *Wedbush Sec. Inc.*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794, at *60 n.88 (Aug. 12, 2016) (finding that "neither the imposition of the suspension on Wedbush nor any other action of FINRA in this matter imposed an unnecessary or inappropriate burden on competition"), *aff'd*, 719 F. App'x 724 (9th Cir. 2018); *cf. Exchange Servs., Inc. v. SEC*, 797 F.2d 188, 191 (4th Cir. 1986) (stating that "any burden on competition created by the overly comprehensive exam is outweighed by the necessity for public interest

protection"); *James Lee Goldberg*, Exchange Act Release No. 66549, 2012 SEC LEXIS 762, at *29 (Mar. 9, 2012) (finding any burden on competition outweighed by the public interest).

Here, the public interest in expelling Newport is paramount. Newport marginalized the supervision of its representatives when it ignored glaring red flags of unsuitable trading and churning and was complicit in the misconduct to its financial benefit. The fact that BrokerCheck will alert potential investors and employers that a representative previously was associated with a disciplined firm like Newport is central to BrokerCheck's purpose in providing investors with valuable information on the background of firms and brokers and imposes no undue burden. *Putting Investors First*, www.finra.org/sites/default/files/InvestorDocument/p014341.pdf, at 5 (last visited Sept. 19, 2018).

BrokerCheck serves as a guardrail for investor protection. As a service to investors, the Commission advises the public to consult BrokerCheck before investing to "make sure your brokers, investment advisers, and investment adviser representatives have not had disciplinary problems or been in trouble with regulators or other investors." *Protect Your Money: Check Out Brokers and Investment Advisers*, https://www.sec.gov/reportspubs/investor-publications/investor-brokershtm.html (last visited Sept. 19, 2018). When approving the expansion of FINRA Rule 8312 related to BrokerCheck disclosures, the Commission stated that, "FINRA should continuously strive to improve BrokerCheck because it is a valuable tool for the public in deciding whether to work with an industry member." *Order Approving a Proposed Rule Change Relating to Availability of Information Pursuant to FINRA Rule 8312 (FINRA BrokerCheck)*, 74 Fed. Reg. 61193, at 61196 (Nov. 23, 2009). In endorsing the public interest in BrokerCheck disclosures, the Commission explained that the information available "will help members of the public to protect themselves from unscrupulous people and thus the proposed

rule change should help prevent fraudulent and manipulative acts and practices, and protect investors and the public interest." *Id.* at 61195.

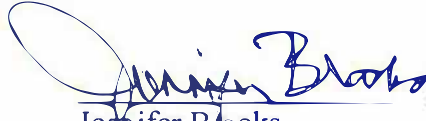
Thus, there is no undue burden on competition in expelling Newport. The public interest exponentially outweighs any purported collateral consequence that Newport contends the expulsion may have on its former representatives who were associated with a disciplined firm.

## V. CONCLUSION

Newport victimized 21 customers who had relied upon the firm and its representatives as securities professionals to trade in their best interest. Newport permitted its representatives to exploit their positions of trust and confidence by excessively trading and churning these customers' accounts over the course of several years. Newport also disregarded its obligation to recommend qualitatively suitable investments to several of these same victims. Newport exhibited an utter disregard for the federal securities laws, FINRA and NASD rules, and the customers' expectations.

By engaging in fraud, egregious suitability violations, and wholesale supervisory failures, Newport has demonstrated that the firm is not fit to participate at any time in the securities industry. An expulsion is entirely appropriate for Newport's dereliction of its most basic obligations as a FINRA member. The Commission should sustain FINRA's action in all respects and dismiss the application for review.

Respectfully submitted,



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September 27, 2018

## CERTIFICATE OF SERVICE

I, Jennifer Brooks, certify that on this 27th day of September 2018, I caused a copy of the foregoing Brief of FINRA in Opposition to Application for Review, in the matter of the Application for Review of Newport Coast Securities, Inc., Administrative Proceeding File No. 3-18555, to be served by messenger on:

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

and via FedEx and email on:

John W. Stenson
Winget Spadafora & Schwartzberg LLP
1900 Avenue of the Stars, Suite 450
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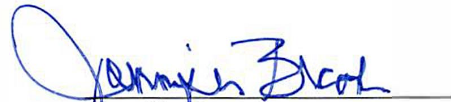
Service was made on the Commission by messenger and on the applicant by overnight delivery service and email due to the distance between FINRA's offices and the applicant.



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## CERTIFICATE OF COMPLIANCE

I, Jennifer Brooks, certify that this brief complies with the Commission's Rules of Practice by filing a brief in opposition not to exceed 14,000 words. I have relied on the word count feature of Microsoft Word in verifying that this brief contains 13,592 words.

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September 27, 2018

BY MESSENGER

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Room 10915
Washington, DC 20549-1090

RE: In the Matter of the Application for Review of Newport Coast Securities, Inc.
Administrative Proceeding No. 3-18555

Dear Mr. Fields:

Enclosed please find the original and three (3) copies of FINRA's Brief in Opposition to Application for Review in the above-captioned matter.

Please contact me at (202) 728-8083 if you have any questions.

Very truly yours,

Jennifer Brooks

Enclosures

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