BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

In the Matter of the Application of

DreamFunded Marketplace, LLC, and Manuel Fernandez

For Review of Disciplinary Action Taken by

FINRA

Administrative Proceeding No. 3-20639

FINRA'S SUPPLEMENTAL BRIEF ON CONSTITUTIONAL ISSUES

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I. INTRODUCTION

Applicants DreamFunded Marketplace, LLC ("DreamFunded"), and Manuel Fernandez have not shown that FINRA's disciplinary proceeding violated their rights under the Seventh Amendment. The courts and the Securities and Exchange Commission long have recognized that FINRA, a private self-regulatory organization and national securities association registered under the Securities Exchange Act of 1934 (the "Exchange Act"), is not bound by the Seventh Amendment. The Supreme Court's decision in *SEC v. Jarkesy*, 144 S. Ct. 2117 (2024), has no bearing on FINRA or the process by which FINRA disciplined the Applicants. FINRA is not a state actor and, as the Commission previously has held, a FINRA disciplinary proceeding is not a "suit at common law" within the meaning of the Seventh Amendment. Accordingly, the Seventh Amendment does not apply to FINRA's disciplinary proceedings. Moreover, the Applicants forfeited any right they might otherwise have had to a jury trial by failing to exhaust their Seventh Amendment argument before FINRA and voluntarily agreeing to participate in FINRA's proceeding. The Commission should sustain FINRA's decision in all respects and dismiss the application for review

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II. BACKGROUND

A. FINRA Is a Private Self-Regulatory Organization

Self-regulation in the securities industry is nearly as old as the nation itself. *See Alpine Sec. Corp. v. FINRA*, No. 23-5129, 2024 U.S. App. LEXIS 29728, at *5 (D.C. Cir. Nov. 22, 2024); *Kim v. FINRA*, 698 F. Supp 3d. 147, 162 (D.D.C. 2023), *appeal docketed*, No. 23-7136 (D.C. Cir. Oct. 19, 2023); *SEC Concept Release Concerning Self-Regulation*, 69 Fed. Reg. 71256, 71257 (Dec. 8, 2004) (S7-40-04). When Congress adopted the Exchange Act, it kept the "traditional process of self-regulation" of the securities industry. *United States v. Solomon*, 509 F.2d 863, 869 (2d Cir. 1975). The Exchange Act, as amended, thus supplements the Commission's regulation of the securities industry with a system of "cooperative self-regulation." *United States v. NASD*, 422 U.S. 694, 700 n.6 (1975). Under this statutory scheme, private self-regulatory organizations, like FINRA, exercise a primary supervisory role over the securities industry, subject to the Exchange Act's requirements and the Commission's close supervision. 15 U.S.C. §§ 78o-3, 78s; *Saad v. SEC*, 873 F.3d 297, 299-300 (D.C. Cir. 2017).

FINRA is currently the only registered national securities association, and it exercises regulatory authority over member broker-dealers and associated persons that conduct business in the national securities markets. *Alpine*, 2024 U.S. App. LEXIS 29728, at *10.[1] FINRA is a private, not-for-profit Delaware corporation. *Scottsdale Cap. Advisors Corp. v.* FINRA, 844 F.3d 414, 417-18 (4th Cir. 2016); Restated Certificate of Incorporation of Financial Industry Regulatory Authority, Inc. (July 15, 2010), https://www.finra.org/rules-guidance/rulebooks/corporate-organization/restated-certificate-incorporation-financial. FINRA

[1] Funding portals must register with the Commission and become a member of a national securities association. *See* 15 U.S.C. § 78c(h).

is financed primarily through member fees and does not receive any funding from the federal government. *Alpine Sec. Corp. v. FINRA*, No. 23-5129, 2024 U.S. App. LEXIS 29728, at *63 n.75 (D.C. Cir. 2024); FINRA By-Laws, art. VI, § 1. FINRA's board comprises 22 members, who are selected by either the FINRA board or FINRA members; no FINRA board member is appointed by the Commission or any other government entity. *See Kim*, 698 F. Supp 3d. at 157; FINRA By-Laws, Art. VII, §§ 4, 10, 13.

FINRA adopts its own rules, which are subject to Commission review, approval, and modification. *See* 15 U.S.C. §§ 78s(b), (c); *Turbeville v. FINRA*, 874 F.3d 1268, 1270 (11th Cir. 2017). FINRA enforces these rules, and the Exchange Act and the rules and regulations thereunder, through internal proceedings that FINRA may initiate to discipline FINRA members and associated persons. *See* 15 U.S.C. § 78o-3(b)(7); *Turbeville*, 874 F.3d at 1271.

FINRA's Commission-approved rules establish a "multi-layered hearing and appeals process" that governs its disciplinary proceedings. *Id.* at 1271; *see also* FINRA Rule 9000 Series. After FINRA alleges misconduct by a member or associated person in a complaint, a FINRA hearing panel conducts an evidentiary hearing to decide whether the firm or individual engaged in the misconduct alleged, and if so, whether to impose sanctions. *See generally* FINRA Rule 9200 Series. A party to a FINRA disciplinary proceeding may appeal the hearing panel's findings and sanctions to the National Adjudicatory Council ("NAC"), FINRA's appellate adjudicator. *See* FINRA Rule 9311(a). The NAC's decision generally is FINRA's final disciplinary action. *See* FINRA Rule 9349(c).

A respondent disciplined by final FINRA action may, as a matter of right, apply to the Commission for a de novo review of the NAC's decision. 15 U.S.C. § 78s(d)(2). A party

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aggrieved by a Commission order upholding FINRA imposed sanctions may seek judicial review in a federal court of appeals. *See* 15 U.S.C. § 78y(a)(1).

B. The Applicants Pursue an Appeal to the Commission After FINRA Disciplines Them

In September 2021, the NAC found the Applicants liable for violating FINRA rules and SEC Regulation Crowdfunding Rules. *See* RP 4890. The NAC imposed three separate bars and expulsions on Fernandez and DreamFunded, respectively, for: (1) failing to provide banking and accounting records, in violation of FINRA Rule 8210 and FINRA Funding Portal Rules 800(a) and 200(a); (2) making false statements and engaging in deceptive practices, in violation of FINRA Funding Portal Rule 200(a) and (b); and (3) failing to implement policies and procedures reasonably designed to supervise DreamFunded and its associated persons, in violation of SEC Crowdfunding Rule 403 and FINRA Funding Portal Rules 200(a) and 300(a). *See* RP 5112. Fernandez and DreamFunded appealed FINRA's decision to the Commission, and the parties completed merits briefing in August 2022.

In August 2024, Fernandez filed a Motion for Reconsideration and/or Relief from Judgment Based on New Precedent, Statute of Limitations and Jurisdiction Issues (the "Motion for Reconsideration"). In this motion, Fernandez raised a Seventh Amendment challenge to FINRA's disciplinary proceeding based on the Supreme Court's decision in *SEC v. Jarkesy*.

In response to the Motion for Reconsideration, FINRA filed a Motion to Strike and Stay Briefing on Applicants' Motion (the "Motion to Strike"). In its motion, FINRA asked the Commission to strike the Motion for Reconsideration on grounds that it was an unauthorized supplemental brief submitted in violation of the Commission's Order Scheduling Briefs in this matter. FINRA also asked the Commission to stay briefing on the Motion for Reconsideration while the Motion to Strike was pending.

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In October 2024, the Commission issued its Order Granting Motion to Submit Supplemental Briefing and Denying Motion to Strike and Stay Briefing. In this order, the Commission (1) stated that it would construe the Motion for Reconsideration as both a supplemental brief and a motion to submit a supplemental brief, (2) granted the motion to submit a supplemental brief, (3) denied the Motion to Strike, (4) accepted as briefs the Motion for Reconsideration and the Motion to Strike, (5) authorized Applicants to submit a supplemental brief by November 22, 2024, and (6) authorized FINRA to submit a response by December 20, 2024. Fernandez filed his Supplemental Brief on November 8, 2024.

III. ARGUMENT

The Applicants contend that their "right to a jury trial under the Seventh Amendment was violated by [] FINRA's use of in-house adjudication," and that the sanctions FINRA imposed on them "should be re-evaluated in light of *Jarkesy*[.]" Supplemental Brief ¶¶ 14-15. The Applicants' argument fails for several reasons.

First, the Applicants' argument fails because they have not shown that FINRA is a state actor. To establish that FINRA violated their Seventh Amendment right to a jury trial, the Applicants must, as "a threshold requirement," demonstrate "that in denying [their] constitutional rights, [FINRA's] conduct constituted state action." *Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999); *see also Manhattan Cmty. Access Corp. v. Halleck*, 587 U.S. 802, 808 (2019) ("In accord with the text and structure of the Constitution, this Court's state-action doctrine distinguishes the government from individuals and private entities."). FINRA is a private self-regulatory organization, and the Applicants have not shown that FINRA's disciplinary action against them is one of the "few limited circumstances," *id.* at 809, in which a private entity's conduct is "fairly attributable to" the government and thus state action subject to

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constitutional requirements, *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982). Because there is no state action here, Applicants' Seventh Amendment argument must be rejected. *See Desiderio*, 191 F.3d at 206 (rejecting a Seventh Amendment claim because the "requisite state action" was absent); *Kim*, 698 F. Supp 3d at 154 (holding that constitutional challenges to FINRA disciplinary proceeding were unlikely to succeed on the merits based on absence of state action).

Second, nothing in *Jarkesy* has any bearing on FINRA or this disciplinary proceeding. In *Jarkesy*, the Supreme Court made clear that the issues it confronted concerned "the basic concept of separation of powers that flow from the scheme of a tripartite government" and the ability of Congress to "withdraw from judicial cognizance" a matter that was the subject of a "suit at common law" at the time of the Founding under the Seventh Amendment. *Jarkesy*, 144 S. Ct. at 2134. The Applicants do not explain how the separation of-powers principles regarding the exercise of the "judicial Power of the United States," U.S. Const. art. III, §1, apply to FINRA, a private self-regulatory organization.

Moreover, the Applicants' argument fails because a FINRA disciplinary proceeding is not a "suit at common law" that arguably must be tried to a jury in an Article III court. The hallmark the Supreme Court has looked to in determining whether a matter is a suit at common law is whether it is "made of the stuff of the traditional actions at common law tried by the courts at Westminster in 1789." *Jarkesy*, 144 S. Ct. at 2132. In making this determination, the Supreme Court considers "centuries old rules" and "historic categories of adjudications" outside courts. *Id.* at 2133-34. The self-regulatory mechanisms of the securities industry, which have involved private investigation and adjudication of broker conduct since the 1790s, have never been "the stuff of the traditional actions at common law." *Id.* at 2133-34. Rather, they have

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been "the stuff of" private self-regulation of the securities industry pursuant to privately developed and implemented procedures—a system that Congress embraced in the 1930s with the passage of the Exchange Act and has reaffirmed numerous times since.[2] Indeed, the

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[2] A FINRA disciplinary proceeding is, at its core, an ethical proceeding—not a suit at common law. "High standards of commercial honor and just and equitable principles of trade" is an expression of an ideal that predates federal regulation of the securities markets. 1 Charles H. Meyer, *The Law of Stock Brokers and Stock Exchanges* 107 (1931). Consistent with this ideal, FINRA Rule 2010 and Funding Portal Rule 200(a) state that FINRA members and funding portal members, respectively, "in the conduct of [their] business, shall observe high standards of commercial honor and just and equitable principles of trade." These rules "implement[] and incorporate[]" the "basic requirement" under Section 15A(b)(6) of the Exchange Act, 15 U.S.C. § 78*o*-3(b)(6), that the rules of a national securities association "must, among other things, be designed to prevent fraudulent and manipulative acts and practices and 'to promote just and equitable principles of trade.'" *Valley Forge Sec. Co.*, 41 S.E.C. 486, 490 (1963); *accord All. for Fair Bd. Recruitment v. SEC*, No. 21-60626, 2024 U.S. App. LEXIS 31475, at *37 (5th Cir. Dec. 11, 2024) ("To comply with the provision, SROs . . . have adopted broadly worded 'J&E rules' – general rules that require [their] members to abide by just and equitable principles of trade. . . . [The] SEC and courts have uniformly emphasized that … SRO J&E rules state[] a broad *ethical* principle [that] implements the requirements of [the J&E provision].") (emphasis in original).

Under FINRA Rule 2010 and Funding Portal Rule 200(a), FINRA may discipline a member or funding portal members, and their associated persons, for any business-related conduct that is unethical, even if the conduct does not involve a security or violate any law. *See Vail v. SEC*, 101 F.3d 37, 39 (5th Cir. 1996) ("[T]he SEC has consistently held that [FINRA's] disciplinary authority is broad enough to encompass business-related conduct that is inconsistent with just and equitable principles of trade, even if that activity does not involve a security."); *Valley Forge*, 41 S.E.C. at 490 (FINRA has "a statutory responsibility to prevent unethical practices among its membership whether or not such practices constitute actual violations of law"). Business-related conduct that violates the securities laws or rules—as is the case with Applicants' conduct—also violates the securities industry's ethical norms. *See All. for Fair Bd. Recruitment*, 2024 U.S. App. LEXIS 31475, at *39 ("It is obviously unethical to violate the law. . . ."); *Valley Forge, 41 S.E.C.* at 488 (stating that FINRA "has . . . uniformly considered violations of the securities acts and the rules and regulations issued thereunder as constituting conduct contrary to just and equitable principles of trade"). Accordingly, a member or associated person who violates the securities laws is subject to discipline for an ethical violation under FINRA rules. *See, e.g.*, *All. for Fair Bd. Recruitment*, 2024 U.S. App. LEXIS 31475, at *38 ("SROs have frequently applied [FINRA Rule 2010 and similar rules] to discipline [their] members for conduct that is unethical, such as[] violating the securities laws"); *Stephen J. Gluckman*, 54 S.E.C. 175, 185 (1999) ("[FINRA's] determination that Gluckman violated [FINRA Rule 2010] is in accord with our long-standing and judicially-recognized policy that a violation of another Commission or [FINRA] rule or regulation . . . constitutes a violation of [FINRA Rule 2010].").

[Footnote continued on next page]

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Commission previously has found that FINRA disciplinary actions are not suits at common law, and therefore the Seventh Amendment does not apply to them. *See Daniel Turov*, 51 S.E.C. 235, 238 (1992) ("A disciplinary hearing before a self-regulatory organization is . . . no[t] a 'suit at common law' within the meaning of the Seventh Amendment. The guarantees pertaining to trials by jury . . . are therefore inapposite.").[3]

Third, the Applicants' argument fails because they did not exhaust it before FINRA. *See, e.g., Newport Coast Sec. Inc.*, Exchange Act Release No. 88548, 2020 SEC LEXIS 911, at *38 (Apr. 3, 2020) ("[I]mposing an exhaustion requirement promotes the efficient resolution of disciplinary disputes between SROs and their members and is in harmony with Congress's delegation of authority to SROs to settle, in the first instance, disputes relating to their operations."). Nothing prevented Applicants from raising their Seventh Amendment argument before now, this issue has been litigated many times before, and as explained above, the courts and the Commission have held consistently that FINRA is not a state actor whose disciplinary

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[Cont'd]

Disciplining FINRA members and their associated persons for violating ethical norms of the securities industry, a quintessentially self-regulatory action, is not "the stuff of" a suit at common law requiring a jury trial in an Article III court. *See Jarkesy*, 144 S. Ct. at 2132; *see also All. for Fair Bd. Recruitment*, 2024 U.S. App. LEXIS 31475, at *37 ("[T]he J&E provision simply requires [self-regulatory organizations] to promote behavior that is morally right and in conformity with the rules and customs of the securities profession.").

[3] Because a FINRA disciplinary action is not in the nature of a suit at common law, there is no basis for the Applicants' assertion that FINRA's allegations of violation "are legal claims for which the Seventh Amendment applies." Supplemental Brief ¶ 67. The Commission may review the NAC's findings of violation and the sanctions it imposed under the statutory review scheme provided under Section 19(e) of the Exchange Act, 15 U.S.C. §78s(e). *Cf. Jarkesy*, 144 S. Ct. at 2132 (finding "no involvement by an Article III court in the initial adjudication is necessary" when a common law claim is not present); *Harold T. White*, 3 S.E.C. 466, 533 (1938) (finding that a Commission proceeding that may result in suspension or expulsion of a member or officer of national securities exchange is "analogous to a proceeding for the revocation of a license and is neither a criminal action nor a suit at law").

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actions are subject to the constraints of the Seventh Amendment." *See Newport Coast*, 2020 SEC LEXIS 911, at *41 (explaining that "unawareness of the availability of the claim does not excuse the failure to exhaust it, even assuming for sake of argument . . . that an intervening change in the law might constitute a reasonable ground to excuse the failure to exhaust"); *see also Malouf v. SEC*, 933 F. 3d 1248, 1257-58 (10th Cir. 2019) ("[Petitioner] cannot avoid the exhaustion requirement based on an intervening change in the law" when he could have invoked the same argument raised in cases decided after the conclusion of his administrative case). Accordingly, the Applicants forfeited this argument by not raising it before FINRA. *See Shlomo Sharbat*, Exchange Act Release No. 93757, 2021 SEC LEXIS 3647, at *16-17 & n.44 (Dec. 13, 2021) (finding that applicant waived his due process argument); *Kabani & Co.*, Exchange Act Release No. 80201, 2017 SEC LEXIS 758, at *45-46 (Mar. 10, 2017) (finding that applicant forfeited his Seventh Amendment argument).

Lastly, the Applicants' argument fails because the terms of FINRA membership are contractual in nature, and the Applicants forfeited any right they might otherwise have had to a jury trial. *See CFTC v. Schor*, 478 U.S. 833, 848 (1986) (finding that jury-trial rights are "subject to waiver, just as are other personal constitutional rights"). FINRA members and associated persons registered with FINRA—including funding portal members and their associated persons—have voluntarily agreed to participate in FINRA proceedings, and thus relinquished any right they might have to a jury trial in federal court. *See id.* at 850*; see also* FINRA Funding Portal Rule 100(a) (stating that all funding portal members and their associated persons are subject to FINRA's By-Laws and FINRA Regulation By-Laws, unless the context requires otherwise, and FINRA's funding portal rules).

IV. CONCLUSION

The Seventh Amendment does not apply to this proceeding because FINRA is not a state actor, and this proceeding is not a suit at common law. Moreover, the Applicants forfeited any right they might otherwise have had to a jury trial by failing to exhaust their Seventh Amendment argument before FINRA and voluntarily agreeing to participate in FINRA's proceeding. The Commission should sustain FINRA's decision in all respects and dismiss the application for review.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I, Michael M. Smith, certify that I have complied with the Commission's Rules of Practice by filing an opposition that omits or redacts any sensitive personal information described in Rule of Practice 151(e).

I further certify that this brief complies with the Commission's Order Granting Motion to Submit Supplemental Briefing dated October 25, 2024, which permits FINRA to file a response brief not to exceed 5,000 words. I have relied on the word count feature of Microsoft Word in verifying that this brief contains 3,050 words.

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Dated: December 20, 2024

CERTIFICATE OF SERVICE

I, Michael M. Smith, certify that on this 20th day of December 2024, I caused a copy of FINRA's Supplemental Brief on Constitutional Issues, in the *Matter of Application for Review of Manuel Fernandez and DreamFunded Marketplace, LLC*, Administrative Proceeding File No. 3-20639, to be filed through the SEC's eFAP system and served by electronic mail on:

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