UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Admin. Proc. File No. 3-21933

In the Matter of the Application of

NYPPEX, LLC and LAURENCE G. ALLEN

For Review of Disciplinary Action Taken by FINRA

REPLY BRIEF OF
NYPPEX, LLC AND LAURENCE G. ALLEN

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I. INTRODUCTION

In this matter, FINRA used its Rule 8310 to impose punishments on Applicants after an in-house proceeding that parallels the language and outcome of criminal matters conducted in federal courts, but without any of the courts' constitutionally mandated safeguards. Defendants in federal prosecutions, unlike Applicants here, have due process protections, including the formal separation of the roles of prosecutor, factfinder, and adjudicator, a required *mens rea*, and a burden of proof imposed on the prosecutor. FINRA's terminology, which explicitly reflects its prosecutorial mindset and operations: (1) calls administrative claims "charges;" (2) calls allegations of rule non-compliance "violations;" and (3) calls monetary sanctions "fines." Although it uses the broader term "sanctions" rather than "punishments," it used its in-house *Sanction Guidelines*[1] just as a U.S. District Court uses the *Sentencing Guidelines*,[2] to determine the baseline fine amounts and imposed *de facto* sentences — monetary penalties, suspensions, and permanent bars from the securities industry. As in any federal criminal matter, FINRA is supposed to consider "aggravating" and "mitigating" factors (albeit based on strict liability) to increase or decrease the "recommended" fine amounts and *de facto* sentences.

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[1] FINRA notes that, "[a]lthough the Commission is not bound by the Guidelines, it uses them 'as a benchmark in conducting [its] review under Exchange Act Section 19(e)(2).'" (Brief in Opp. at 24) (quoting *Robert Juan Escobio*, Exchange Act Release No. 97701, 2023 SEC LEXIS 1532, at *31 (June 12, 2023)). Hereafter, we refer to these Guidelines as the "*Sanction Guidelines*." https://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf.

[2] A "sentence" is defined as "The judgment that a court formally pronounces after finding a criminal defendant guilty; the punishment imposed on a criminal wrongdoer <a sentence of 20 years in prison>." BLACK'S LAW DICTIONARY (12th ed. 2024). Congress created the U.S. Sentencing Commission as an independent agency in the federal judicial branch when it enacted the Sentencing Reform Act of 1984 "in response to widespread disparity in federal sentencing, ushering in a new era of federal sentencing through the creation of the Commission and the promulgation of federal sentencing guidelines." https://www.ussc.gov/about-page.

FINRA's prosecutor, its Department of Enforcement, is unburdened by any need to show a *mens rea* (at the time of the "violation") at any level of proof: any action or inaction that is addressed in a FINRA Rule — its mandate — is a violation, and a violation automatically creates liability. In turn, liability automatically requires use of the *Sanction Guidelines*. The only issue thereafter is the extent of the penalty FINRA will impose. In this matter, for instance, the *Sanction Guidelines* for noncompliance with Rule 8210, however determined, looked to (1) the alleged importance of the information requested from Applicants "from FINRA's perspective" (i.e., regardless of the information's actual importance or Applicants' knowledge of that importance); (2) the number of requests for that information; and (3) the Applicants' reasons offered "to justify the partial but incomplete response." (FINRA, *Sanction Guidelines* at 30, 93). What constitutes a "valid" reason is not specified, and in this matter was not even addressed until after FINRA had already determined that a fine and *de facto* sentences were mandated, despite the fact that Applicants had, in fact, provided valid reasons for their inability to comply with the requests. (*See* Decl. of Larry Allen ¶¶ 93-103).

According to FINRA, it has a congressionally-delegated power to impose severe penalties ("sanctions") on Applicants for any "incomplete" response to an information-demand — a power that even its government overseer, the Securities and Exchange Commission ("SEC"), lacks. FINRA, noting that it is a private, state-chartered non-profit corporation, asserts more exclusively governmental power than the SEC. Although this argument constitutes an end-run around the U.S. Constitution, FINRA being an ostensible "private actor,"[3] Applicants submit

[3] Exactly why FINRA's sanctions authority, granted as it is supposed to have been by Congress, is also immune from any U.S. Constitution-based constraints on federal power is not adequately explained. For example, if Congress (or the SEC) were to have granted FINRA explicit authority to create rules that require all brokers to profess religious devotion to Dionysus and adherence to traditional Greek religion in order to be licensed, presumably that congressional delegation

that in <u>this</u> *de novo* proceeding before the Commission, in which the SEC – a federal agency and state actor – is being asked to ratify and approve FINRA's recommended "findings" and imposed "sanctions," the SEC is unable to ignore its own constitutionally-imposed limitations as a federal agency.

II. FINRA ERRED IN USING RULE 8310 TO IMPOSE EGREGIOUS PENALTIES ON APPLICANTS

The Supreme Court has noted that, although equitable relief is necessarily remedial, legal relief can be remedial or punitive. Remedy derives etymologically, from "re-healing," and it is "the means employed to enforce a right or redress an injury." *Chelentis v. Luckenbach S.S. Co.*, 247 U.S. 372, 384 (1918) (citing Bouvier's Law Dictionary). Unlike remedies, penalties — including civil penalties such as punitive damages — are generally "aimed not at compensation but principally at *retribution* and deterring *harmful conduct*." *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 492 (2008) (emphasis added).

In this matter, FINRA claims that the fines, suspension, and permanent bar from the securities industry imposed upon Applicants are not penalties but remedies. In other words, although these "sanctions" may look just like penalties, they are not penalties. Nonetheless, their imposition is predicated on a rationale used only for punishment: deterrence. FINRA explicitly acknowledges that the fines and *de facto* administrative sentences it imposed on Applicants for their purported "violations" of FINRA's internal Rule 8210 (not related to investor protection) are predicated on specific deterrence and general deterrence: to protect the investing public from

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would be struck down as unconstitutional because it violates the Free Exercise Clause of the First Amendment.

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Applicants and to dissuade others from not complying with Rule 8210, respectively.[4] (Brief in Opp. at 28, 39).

FINRA does not claim that Applicants harmed the investing public or that their Rule 8210 "violation" harmed the public. In fact, the relevance of the investing public is in the future, to supposedly protect investors from Applicants' future disregard for compliance with Rule 8210. (*Id.* at 39). Nor does FINRA identify any "injury" to it or claim that its "sanctions" redress any such "injury." Instead, it simply looked to its prescribed guidelines to justify and administer its standardized monetary penalties, which it acknowledges to be fines, and time-based punishments. One cannot distinguish this process of imposing punishments on respondents for *rule-violating conduct* from that of a criminal court imposing fines and sentences on defendants for *law-violating conduct*.

A. FINRA'S Sanctions Are Explicitly Based on (Unwarranted) Deterrence

FINRA confirms that the fines and *de facto* administrative sentences it imposed on Applicants are intended to serve deterrent purposes. For Allen, FINRA confirms its use of specific deterrence: "The record shows that there is a serious risk that Allen would not comply with any requests issued to him under FINRA Rule 8210 in the future, which would put investors at risk. *The bar therefore will protect investors*." (Brief in Opp. at 39) (emphasis added.). It cites to J*oseph Ricupero*, Exch. Act Rel. No. 62891, 2010 SEC LEXIS 2988, at *26 (Sept. 10, 2010), aff'd, 436 F. App'x 31 (2d Cir. 2011), for the proposition that a lifetime bar not only "protects investors from any further FINRA Rule 8210 violations," but that the permanent bar on Allen promotes <u>general deterrence</u> by "encourag[ing] cooperation by others." (Brief in Opp. at 39). As

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[4] FINRA acknowledged that, "[b]ecause the NAC barred Allen for his FINRA Rule 8210 violation, it did not impose sanctions on him for any other violation." Opp. Br. at 1, n.1.

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for the broker-dealer, the "one-year suspension for NYPPEX will protect investors by encouraging the firm to cooperate with future FINRA Rule 8210 requests." (*Id.*).

These are not remedial justifications to redress harm: they are retributive and deterrence-based reasons for imposing penalties. In addition, FINRA's justifications are not even based on any finding that Applicants harmed any investors or even "harmed" FINRA.[5] Because FINRA has made no finding that Applicants harmed any investors, it has no justifiable basis for peering into the future to protect the investing public and mete out retribution for having violated a FINRA mandate unrelated to investors. The record makes it obvious that Applicants were punished for disobedience, and then for complaining about the consequences of such "disobedience." In this matter, Rule 8210 had adverse consequences on Applicants greater than many provisions in Title 18 of the U.S. Code.

B. FINRA'S Sanctions Were Not Intended to Redress Any Harm

The *de facto* administrative sentences that FINRA imposed on Applicants arose from their purported "violations" of Rule 8210. In calling these *de facto* sentences "remedies," FINRA rewrites the law of remedies and punishments. Its use of what are effectively sentencing guidelines for rule violations is not designed to address and redress the harm or impaired rights of a complaining party. The use of the *Sanction Guidelines* imposes standardized retribution for breaking FINRA rules. The "sanctions" are not intended to return any harmed party — FINRA or

[5] Moreover, FINRA ignored mitigating factors in imposing its draconian penalties. Even under the *Sanction Guidelines*, the existence of mitigating factors warrants a temporary suspension, as opposed to a permanent bar. *Sanction Guidelines* at 93. FINRA's NAC decision does not factor in or consider mitigation. Applicants had no prior FINRA or SEC regulatory violations, there was no harm to investors from Applicants' supposed violations, Mr. Allen's 36-year career in the securities industry was exemplary and he had never been involved in any kind of disciplinary action, and he repeatedly sought to provide FINRA with the documents the staff had demanded, even when he did not have unfettered control over the documents. (Decl. of Larry Allen ¶¶ 93-103).

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the investing public — to the status quo *ante*. Nor are they orders to compel compliance with a Rule 8210 information demand. An order compelling compliance, in the context of an SEC administrative subpoena, would require the Commission to file an action in federal court and obtain an order from an Article III judge. Consequences for a party's failure to follow the court's mandate then flows from the court's authority, exercised consistent with constitutional safeguards. Instead, FINRA's sanctions are, simply, punishments for failing to follow FINRA Enforcement Staff's instruction to produce information.

FINRA does not assert that Applicants' Rule 8210 response caused any harm to investors and cannot claim that it even harmed FINRA. Applicants proffered the documents under Rule 8210 subject to the condition of confidentiality, but FINRA *refused to look at them online* or *to accept them in hard copy*. (Decl. of Laurence Allen ¶¶ 96-100). These refusals constitute evidence that FINRA did not, in fact, think that this important information would identify any violations of the federal securities laws or FINRA's substantive rules and that FINRA was more interested in Applicants' compliance with its policy concerning Rule 8210 than it was about past or ongoing harm to public investors.

Because these "sanctions" are imposed for a Rule 8210 "violation," FINRA did not need to identify *any injury and would be unable to specify how its sanctions remedy that injury*. Instead, it uses unwarranted speculation about future conduct and a strained theory of causation to claim that the punishments are remedies for some imagined future investor harm. Although FINRA does not claim that Applicants' past Rule 8210 "violation" harmed it or the investing public, or even prevented FINRA from discovering such harm, FINRA reasons that Applicants' purported past "violation" of Rule 8210 — which involved no finding of *mens rea* — and subsequent "attitude" about that "violation," despite not having caused any investor harm, justify

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its imaginary scenario that: (1) if Applicants receive a future Rule 8210 document demand, they likely will not substantially comply with it; (2) if Applicants do not substantially comply with that future document demand, then FINRA will be unable to determine whether Applicants harmed or are harming future investors; (3) if FINRA were unable to determine whether future investors were harmed or being harmed, such investors would be "at risk" of harm; and (4) if the future investors were at risk of harm, they would likely be victims of such harm. This chain of speculations, in turn, justifies FINRA's imposition of specific deterrence against Applicants, with the "remedies" being the prevention of future injury to future investors by removing Applicants from the industry. This strained reasoning is specious and does not alter the obvious fact: the sanctions are intended to be and are retributive.

C. FINRA'S Sanctions Constitute Punishments and are Penal in Nature

FINRA claims that *because* the sanctions it imposed on Applicants were "within the range recommended in [its in-house] Guidelines," they could not be punitive and must be remedial. (Brief in Opp. at 27-29). FINRA's guidelines, however, have only one function: to impose standard punishments on those whom FINRA, in its entirely-in-house universe, determines have violated, on a strict liability basis, any one or more of its many rules as FINRA interprets such rules in its administrative hearings and appeals. The fact that FINRA relied on and used its *Sanctions Guidelines* in this matter, as it states it did, is evidence that its "relief" against Applicants was retributive and fundamentally unrelated to any remedy. The punishment decreed by FINRA here is perfectly analogous to a criminal sentencing.

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III. FINRA MISSTATES APPLICANTS' *JARKESY* ARGUMENT AND IGNORES WHAT IS AT ISSUE: THE SEC's *DE NOVO* DECISION ABOUT SUSTAINING OR MODIFYING FINRA'S PUNITIVE SANCTIONS

FINRA fundamentally mischaracterizes Applicants' argument about *Jarkesy*, claiming that Applicants argue that "FINRA violated their Seventh Amendment right to a jury trial ...." (Brief in Opp. at 41). It notes that FINRA is a private entity and its disciplinary proceeding is beyond the scope of Article III and the Seventh Amendment. Specifically, it notes that: (1) FINRA is not a state actor; (2) FINRA's disciplinary action is not "fairly attributable to the government;" (3) FINRA's disciplinary proceeding is not subject to Article III; (4) the Seventh Amendment does not apply to a matter assigned to a non-Article III body for adjudication; and (5) Applicants did not "exhaust" their administrative remedies.

This presentation completely ignores Applicants' *actual* argument, which concerns not FINRA's administrative proceeding (the in-house hearing and subsequent review) but *this* administrative proceeding and the SEC's *de novo* review. In its review of FINRA's imposed sanctions: (1) the Commission is a state actor; (2) the Commission's possible decision to approve and thereby ratify FINRA's "sanctions" would be attributable to the government; (3) the Commission's possible adoption of FINRA's recommended sanctions in this matter, regardless of the underlying matter's origin with FINRA or the Commission, would render the Commission's proceeding subject to Article III; (4) the Commission's possible adoption of FINRA's recommended sanctions in this matter would violate the Seventh Amendment; and (5) Applicants were not required to "exhaust" this argument in FINRA's proceedings since, as FINRA states, FINRA is not a state actor and the argument would have been futile in any event – falling, as it would have, on deaf ears.[6]

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[6] There is no statutory mandate that requires Applicants to "exhaust" their arguments before FINRA. *See, e.g.*, *Moore v. City of East Cleveland*, 431 U.S. 494, 497 n.5 (1977) ("[T]hose cases

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FINRA's sanctions in this case are punitive in nature: they are not intended to "restore the victim" nor do they "solely" serve a remedial purpose because they, as admitted by FINRA, "*also* serv[e] either retributive or deterrent purposes," and therefore are punishment for the purposes of the Seventh Amendment. *SEC v. Jarkesy*, 144 S. Ct. 2117, 2129 (2024) (emphasis added). Expulsion and suspension are punitive and therefore "oppressive and excessive." *Id.*; *see also*, *Saad v. SEC*, 873 F.3d 297, 304 (D.C. 2017) (Kavanaugh, J., concurring). The sanctions imposed against Applicants by FINRA in this matter are punitive in nature and the SEC's *de novo* approval and ratification of these penalties would be contrary to Applicants' Seventh Amendment rights as articulated in *Jarkesy*.

IV. CONGRESS COULD NOT DELEGATE TO FINRA THE EXCLUSIVELY GOVERNMENTAL POWER TO PENALIZE APPLICANTS FOR "NON-COMPLIANCE" WITH FINRA'S INFORMATION DEMANDS

FINRA claims that Congress delegated to it (1) the power to make information demands on respondents; (2) the power to compel respondents' compliance with information demands; and (3) the power to impose penalties on respondents who do not comply, as FINRA determines, with such information demands. FINRA cannot explain, however, how Congress delegated to it — a state-chartered non-profit corporation — more governmental authority concerning information demands than Congress legislated for the SEC. Nor does FINRA explain why the SEC must seek a judicial order to obtain non-forthcoming responses to its information demands (administrative subpoenas), while FINRA can simply impose fines and the equivalent of

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that have denied certain nonconstitutional defenses to criminal defendants for failure to exhaust remedies did so pursuant to statutes that implicitly or explicitly mandated such a holding."). This is particularly true when exhaustion would have been futile. *Id.* ("[T]his Court has never held that a general principle of exhaustion could foreclose a criminal defendant from asserting constitutional invalidity of the statute under which she is being prosecuted.") (citing Y*akus v. United States*, 321 U.S. 414, 446-447 (1944)).

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administrative sentences in-house, without any need for a showing of *mens rea* and free of any constitutional safeguards.

FINRA argues that Congress directly delegated to it, as a private entity, a power to impose penalties (or sanctions) directly on other private entities and persons for their alleged noncompliance with its informational demands that it intentionally did not delegate to the Executive-branch agency that oversees FINRA. Under this view, Congress delegated punitive (or sanctioning) powers to FINRA that it did not and likely could not delegate to the agency that oversees FINRA—at least not without the SEC complying with constitutional restraints upon such powers, including seeking enforcement from Article III courts and complying with the Seventh Amendment.[7] FINRA, which is not subject to the restrictions of the Fifth Amendment Due Process Clause, nonetheless claims that this delegation of extraordinary governmental power to a private entity does not violate due process in any event. (Brief in Opp. at 44).

Missing from FINRA's argument, however, is any compelling explanation for why the SEC's ratification of FINRA's decision to impose punitive sanctions on Applicants would not

[7] FINRA's assumption of supremacy in wielding the powers delegated to it by Congress as an SRO under the Exchange Act is overwrought: that authority is circumscribed and dependent upon SEC approval. *Fiero v. FINRA*, 660 F.3d 569, 574 (2d Cir. 2011) (FINRA does not have independent authority under the Exchange Act.). The Commission oversees FINRA by reviewing and approving (or not) proposed FINRA rules and final decisions. 15 U.S.C. § 78s. Among the Commission-approved rules are FINRA's Series 8000, which include Rules 8210 and 8310. *Principal Sec., Inc. v. Agarwal*, 23 F.4th 1080 (8th Cir. 2022); *Luis v. RBC Cap. Mkts., LLC*, 984 F.3d 575, 577 (8th Cir. 2020) (The Exchange Act enables FINRA, as an SRO, "to regulate the financial industry with [Commission] approval."); *PAZ Sec., Inc.*, Exch. Act Release No.57656, 93 S.E.C. Docket 47, 2008 WL 1697153, at *4 (Apr. 11, 2008). To the extent that the SEC approved FINRA powers that violate limitations imposed by the U.S. Constitution, such approval by the SEC would be *ultra vires*, or would itself constitute a constitutional violation and would be subject to an Article III court's review. *E.g.*, *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244, 2273 ("[W]hen a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it.").

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violate the Seventh Amendment. Regardless of FINRA's belief that Congress has granted it munificent authority to do whatever it wants with its members, the SEC is not so unconstrained, and it is the SEC's *de novo* decision to approve and ratify FINRA's punitive remedy that is at issue here.

V. CONCLUSION

For the foregoing reasons, as well as the reasons articulated in Applicants' Opening Brief, Applicants request that the Commission set aside or require the remission of all FINRA-imposed sanctions against Applicants.

Dated: September 20, 2024

Respectfully submitted,

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CERTIFICATE OF SERVICE

In accordance with Rule 151 of the SEC Rules of Practice [17 CFR § 201.151], I hereby certify that a true copy of the foregoing Motion for Extension of Briefing Schedule was served on the following on this 20th day of September, 2024, in the manner indicated below:

Via the Commission's Electronic Filings in Administrative Proceedings:
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