CARLTON FIELDS

The Hits Keep Coming for FINRA, Closing Out a Brutal Summer

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It's not just the New York Yankees that wish they could put the summer behind them. We previously wrote about the shocking blow the D.C. Circuit Court of Appeals dealt FINRA in early July by enjoining the self-regulatory organization from expelling Alpine Securities Corp. based on Alpine's challenge to the constitutionality of FINRA hearing officers. Specifically, Alpine alleged that FINRA's enforcement action against it violated the Constitution because FINRA's hearing officers wield executive powers that may be exercised only by the president and officers under his supervision. FINRA, not used to losing in federal court, sought reconsideration from the full D.C. Circuit. On August 22, 2023, the D.C. Circuit denied FINRA's request, leaving in place the injunction that prohibits FINRA from expelling Alpine. The full D.C. Circuit denial is significant because surely the regulator had hoped it drew a bad panel with one outspoken judge. This left FINRA with nothing to say except that it "looks forward to the D.C. Circuit's consideration of [Alpine's] appeal, when FINRA and the United States Government will present their defenses to plaintiffs' novel and unsupported constitutional arguments." FINRA's defeated statement sounds like a beleaguered defense attorney mustering up enough hope on the courthouse steps after a jury quickly and resoundingly convicted his client. If Alpine was not enough of a headache for FINRA, last week, Eugene Kim, a FINRA-registered representative, filed a complaint in the U.S. District Court for the District of Columbia alleging that FINRA's current structure and operations violates the Constitution's separation of powers provisions, including the appointments, removal, and non-delegation clauses. Next, Kim alleges that FINRA's enforcement program violates various constitutional amendments. Finally, Kim alleges that FINRA's securities SRO power violates the Sherman Act (an antitrust law) because "FINRA has monopolized the SRO market." It is no coincidence that Kim, a New Jersey resident, chose to file in the district court in D.C., where the D.C. Circuit has suggested FINRA's untouchable status is far from certain. Unsurprisingly, Kim's complaint borrows the arguments and language from Judge Walker's concurring opinion from Alpine's injunction suit. In some respects, Kim's colorful complaint looks like someone on the brink of being barred throwing a Hail Mary from his own 10-yard line with five seconds on the game clock and down by six points. Nevertheless, some of his arguments may resonate. For instance, Kim argues that while FINRA disavows any Fifth Amendment

protections for its members and associated persons, the regulator's typical practice is to share its findings with the SEC, FBI, U.S. attorney's offices, and state and local law enforcement. Kim is not wrong. In fact, FINRA's website highlights actions resulting from referrals made to federal and state authorities. Kim also is correct that a registered person's invocation of the Fifth Amendment will result in a bar by FINRA. Kim's complaint hits the nail on the head when describing FINRA's disregard for a registered person's Fifth Amendment rights — it presents a Hobson's choice of either testifying against himself or accepting the automatic industry death sentence of a lifetime bar. Now, FINRA will surely argue that because it is a private entity, constitutional protections do not apply. As to the Fifth Amendment, FINRA is absolutely correct. The Fifth Amendment protects a person from being compelled to testify against him or herself. That does not mean, however, that negative collateral consequences may flow from invoking the Fifth Amendment. For instance, in civil litigation, a jury may draw an adverse inference against someone who invokes the Fifth Amendment privilege. Kim's Fifth Amendment arguments are really where his complaint comes full circle with Judge Walker's skepticism of FINRA's disciplinary process. FINRA is a government-authorized not-for-profit overseen and regulated by the SEC, a government agency. FINRA's hearing officers are private employees hired directly by FINRA. These hearing officers act as judge, jury, and, in the case of bars and expulsions, executioner. In *Alpine*, Judge Walker expressed concern that these hearing officers escaped the appointments clause. Kim makes similar arguments, characterizing FINRA as a state actor. Perhaps Kim's most interesting allegation involves section 2 of the Sherman Act, which prohibits the monopolization, or attempted monopolization, of any part of trade or commerce. He alleges that FINRA has monopolized the self-regulatory organization market. We have previously written about FINRA's exclusive authority to control registrations (commonly referred to as "licenses"). At least in the colloquial sense, FINRA does have a monopoly on broker-dealer operations. Yes, the SEC conducts broker-dealer exams and can also bring disciplinary actions, but FINRA is the only regulator that controls the registrations. And those registrations are required for almost everyone working in the securities industry. In short, FINRA has a monopoly over securities registrations. So where does this all end up? Perhaps these issues will end up before the Supreme Court. Some of the concerns raised by Judge Walker in *Alpine* and by Eugene Kim in his complaint are not outlandish, and they deserve careful consideration. FINRA has enjoyed victories throughout the country for many years, but the D.C. Circuit has, at least preliminarily, suggested that it is willing to listen to the concerns that were once summarily dismissed. Thus, if Alpine or Kim prevails through the D.C. Circuit, it will be perfectly situated for Supreme Court review.

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