Edward S. Brokaw
v.
FINRA Department of Enforcement

Edward S. Brokaw's Opening Brief in Support of Application for Review
Administrative Proceedings File No. 3-15059

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Respectfully submitted,

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In the Matter of Application of Edward S. Brokaw
Administrative Proceeding File No. 3-15059

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EDWARD S. BROKAW'S OPENING BRIEF IN SUPPORT OF APPLICATION FOR REVIEW

Edward S. Brokaw, by and through his undersigned counsel, hereby submits this opening brief in Support of his Application For Review of the National Adjudicatory Council's findings that he allegedly violated NASD Rules 2110 and 3110 issued on September 14, 2012 (hereinafter the "NAC Decision"). Mr. Brokaw hereby requests oral argument before the Securities and Exchange Commission ("SEC") to hear this appeal. To assist the SEC, this brief is divided into the following sections: (I) Brief Introduction; (II) FINRA's Overzealous Prosecution of Mr. Brokaw; (III) Exception to the Findings of Facts in the NAC Decision; (IV) The Controlling Legal Standards; and (V) Exception to the Issuance of Sanctions. All citations are to the official record (hereinafter **R** with page number).

I. Brief Introduction

The most recent NAC Decision dated September 14, 2012 in the case entitled Department of Enforcement vs. Edward S. Brokaw, Complaint No. 2007007792902, was partially correct in overturning the utterly baseless manipulation charges against Mr. Brokaw, both as an alleged

primary wrongdoer as well as an aider and abettor. **[R012471; R012481]**. At the oral argument of Mr. Brokaw's appeal of the original decision dated June 10, 2010 (hereinafter the "June 2010 Hearing Panel Decision"), that effectively stripped Mr. Brokaw of his career despite an unblemished record spanning twenty-seven (27) years, the Department of Enforcement's Lane Thurgood conceded as follows in response to a question from the NAC representative:

> "In and of itself sir, there's nothing wrong with selling shares at the opening, there is nothing wrong with selling shares at the close. The question is what is the intent? And SEC Rule 10(b)-5 prohibits manipulative devices. 10b-5 is the standard and it is met."

[R012405] The NAC Decision correctly decided that the burden of proof for a Rule 10(b)-5 violation was not met. Mr. Brokaw was found not liable as a primary wrongdoer for manipulation nor was he found liable as an aider and abettor. And in fact, the NAC Decision held that Mr. Brokaw's client, Tang Capital Partners, did not engage in a manipulation scheme. The NAC concluded as follows:

> "When we consider all of the other facts before us, however, we conclude that Enforcement has not proven that Brokaw knew or was reckless in not knowing that following KT's (Kevin Tang, the seller of the securities through his hedge fund) directions was manipulative. Brokaw had no discretion over KT's orders – all of which were unsolicited orders. Rather, Brokaw worked these orders through the firm's trading desk, which executed them at prevailing market prices. These facts mitigate against a finding that he was involved in any manipulative scheme."

[R012487].

Of critical importance in reaching this conclusion, NAC correctly weighed the following undisputed facts:

(1) Mr. Brokaw knew generally of Mr. Tang's strategy in selling the common stock of Monogram Bioscience Inc. ("MGRM") during the pricing period; **[R012487]**

(2) Mr. Tang had no prior selling arrangement with Mr. Brokaw and Mr. Brokaw did not know whether he would receive any orders until his client called; **[R012487]**

(3) Kevin Tang had shared his bearish view on the fate of MGRM with Mr. Brokaw; **[R012487]**

(4) Evidence showed that while Mr. Tang had shared the mechanics of how the MGRM CVR's worked, the concept of a hedged position, and Mr. Tang's personal goal to own more CVR's than common stock of MGRM at the conclusion of the pricing period, Mr. Tang never informed Brokaw of the number of MGRM common shares he had to sell during the pricing period, the pace at which he planned to sell those shares or other broker-dealers he was using to accomplish these goals. **[R012487]**

As a result, the NAC Decision concluded that the trades entered by Mr. Tang with Mr. Brokaw and others at Deutsche Bank Securities Inc. ("DBSI") were legitimate market orders. This finding is consistent with the SEC's inquiry into these very same trades by Mr. Tang in 2006 wherein the SEC concluded its investigation after reviewing all of Mr. Tang's trading records in MGRM without any action taken against Mr. Tang. **[R06881]**

Yet, Mr. Brokaw is still being taken to task and unfairly sanctioned in the NAC Decision. The new holding is that Mr. Brokaw violated NASD Rule 2110 (just and equitable principles of trade) and NASD Rule 3110 (books and records violation). The cases cited by NAC are completely distinguishable. In fact, NAC's effort to find fault on Mr. Brokaw's part is entirely inconsistent given the NAC's findings of fact in connection with the holding that Mr. Brokaw did not engage in fraud. Mr. Brokaw submits that the NAC Decision, while partially correct, is just another failed attempt to find Mr. Brokaw liable for something without a legal or factual basis. Such a result would create new obligations for registered representatives well beyond what is legally required.

II. FINRA's Overzealous Prosecution of Mr. Brokaw

In the pre-complaint phase, FINRA leaned heavily on Mr. Brokaw in an attempt to extract a settlement. FINRA sent Mr. Brokaw a Wells letter dated December 12, 2007 and accused Mr. Brokaw of instructing one of his sales assistants, Daniel Aliperti, to fill out certain order tickets in a false and misleading fashion to allegedly camouflage the Tang MGRM trades from Mr. Brokaw's supervisors at DBSI. **[R28-29]**. Specifically, FINRA DOE stated as follows in the Wells letter:

> "Mr. Brokaw also caused the books and records of the firm to be inaccurate by instructing one of his sales assistants to incorrectly fill out trade tickets for trades in Monogram Biosciences on May 19, 22 and 23, 2006. This violated SEC Rule 17(a)-3 and NASD Conduct Rules 3110 and 2110".

[R47]. At the time, Mr. Thurgood, the lead attorney for FINRA's DOE, knew this charge was false because Mr. Thurgood had taken Mr. Aliperti's deposition on September 6, 2007 (three months earlier) and Mr. Aliperti testified at that deposition that he had received the instructions for the trade tickets from Mr. Ewing, and that Mr. Brokaw had not even seen the trade tickets. **[R9362-9363; R9387; R9390]**.

FINRA's Mr. Thurgood was so intent on extracting a settlement from Mr. Brokaw that he attempted to intentionally deceive Mr. Brokaw into believing that FINRA had damning evidence from one of his former sales assistants. Since Mr. Brokaw played no role in creation of trade tickets, he knew this charge to be false and he refused to be intimidated into a settlement. When the ultimate complaint was filed, FINRA's DOE revised this charge to an alleged failure by Mr. Brokaw to ensure the accuracy of the trade tickets. This was a far different charge based on a negligence standard rather than intentional misconduct as set forth in the Wells letter. **[R15]**. Moreover, these were the DBSI branch office "booking tickets" – not the actual order tickets.

The actual order tickets were in fact electronically created by the sales-traders who executed the trades through DBSI's position traders. **[R10995-11054]**

Throughout the FINRA Enforcement proceeding, Mr. Thurgood and others at FINRA acted as if it was "a given" that Mr. Tang had been attempting to manipulate the price of MGRM to maximize his profit on the MGRM CVR's. Neither FINRA nor the Hearing Officer gave any credit to Mr. Tang's extensive testimony that spanned 250 pages of transcript **[R012484]** nor his legitimate trading strategy based on a legitimate economic purpose **[R012484]** and Mr. Tang's experience in selling 4,864,400 shares of MGRM prior to the start of the CVR pricing period. **[R801]**. Specifically, FINRA's Hearing Officer Sarah Nelson Bloom discredited an exhibit created by Mr. Tang concerning the presence of more liquidity at the open and at the close of each trading day involving MGRM common stock during the pricing period. **[R012485]** In the NAC Decision, the NAC Panel concluded as follows:

> "We find the Hearing Panel mischaracterized KT's testimony, which was that KT sold near the open and close because he understood that historically the volume was the highest during these times, which would assure him that his orders were filled. KT's testimony is emphatic that he primarily wanted the shares sold and was less concerned with the price. Because the Hearing Panel's finding was factually inaccurate, we disregard its conclusion that KT's testimony on this point was not credible. Especially in light of the Hearing Panel's silence regarding KT's overall credibility, we find that the totality of the record evidence supports that the open and close of the market provided the highest trading volume."

[R012485, footnote 30]. In their rush to hold Mr. Brokaw liable, such critical evidence was intentionally ignored by FINRA's DOE and conveniently dismissed by the Hearing Panel. While the NAC Decision has gone a long way to remedy that wrong, the finding that Mr. Brokaw violated NASD Rule 2110 is equally wrong based on the facts and the existing case law.

III. Exceptions to Finding of Facts in the NAC Decision

(A) Background

The MGRM CVR's were created in December 2004 in connection with the merger of Aclara BioSicences, Inc. and ViroLogic, Inc. **[R6844-6845]**. The merged entity changed its name to MGRM and issued 1.7 CVR's for each share of Aclara held prior to the merger. **[R2556; R2529]**. The value of the CVR's was established eighteen months after the merger based on the volume weighted average price ("VWAP") of MGRM common stock during a fifteen-day pricing period beginning on May 19, 2006 and ending on June 9, 2006. **[R2566]**. Brokaw's hedge fund client, Tang Capital Partners owned 18,186,287 CVR's with an average cost basis of $0.2357 that were acquired through the original issuance and secondary market transactions. **[R797]**.

At the beginning of the pricing period, MGRM had not yet declared how it would satisfy this liability to the CVR holders. On May 26, 2006, MGRM announced that it intended to satisfy its CVR obligation in cash representing a cash outlay of $57 million **[R759-760]**. At the time, MGRM had approximately $92 million in cash. **[R759-760]**. On June 12, MGRM's Chairman and Chief Executive Officer was quoted in a press release announcing the settlement of MGRM's CVR liability as follows: "By resolving the CVR's, we bring closure to a period of uncertainty regarding our financial situation." **[R761-762]**. Clearly, it was a matter of public record that MGRM was a cash-strapped company.

Footnote 4 of the June 2010 Hearing Panel Decision erroneously stated that "a CVR is a commitment by the issuer to pay additional cash or securities to CVR holders, contingent on the occurrence of a specific event, such as in this case the issuer's share value falling below a certain level by a specified time." **[R11839]**. MGRM CVR's were not contingent on MGRM's stock

price dropping below a certain level by a specified time. **[R2566]**. This is a critical misunderstanding of the evidence by the Hearing Officer. MGRM specifically used a daily VWAP calculation method averaged over a 15 day period to avoid the situation wherein a closing price at the end of the pricing period would determine the value of the CVR's. **[R2571; R6852-6853]**.

More importantly, the June 2010 Hearing Panel Decision gave no weight to the historical price trends in MGRM, and the June 2010 Hearing Panel Decision mistakenly asserted that Pfizer made an investment in MGRM on May 8, 2006. **[R11841; R769-774]**. On the latter point, the evidence is undisputable that Pfizer loaned MGRM $25 million, and the loan, bearing a 3% interest rate, was repayable in 2010 in exchange for certain promises by MGRM granting Pfizer certain valuable rights abroad. **[R748; R757]**. While there was a brief price spike from $1.69 to $2.30 on May 8 after MGRM's overly optimistic press release relating to the Pfizer transaction, MGRM's price started falling prior to the start of the pricing period and continued to fall throughout the pricing period as the natural forces in the market were reacting to MGRM's weakening financial balance sheet. **[R770]**.

The June 2010 Hearing Panel Decision also failed to address the historical VWAP trends for MGRM. The VWAP of MGRM common stock for the thirty, sixty and ninety day trading period leading up to the pricing period was $1.7566, $1.8440 and$1.8811 **[R801]**. The average VWAP after the pricing period concluded from June 12, 2006 in thirty, sixty and ninety day intervals was $1.8173, $1.7305 and $1.6946 **[R801]**. The VWAP during the pricing period was $1.8525. **[R800]**.

As described in the publicly available merger agreements, the MGRM CVR's were going to be valued based on the average VWAP during the pricing period. **[R2571]**. If MGRM's

VWAP was above $2.90, the CVR holders received nothing, and if it was $2.02 and below, the CVR holders would receive a maximum payout of $0.88 per CVR. **[R2571]**. If the MGRM VWAP was between $2.02 and $2.90, the CVR's would be equal to the difference between $2.90 and the VWAP price. **[R2571]**. Based on the historical averages, it was very clear that MGRM's CVR's were likely to be fully valued at the end of the pricing period.

(B) <u>The Relationship Between Tang Capital Partners and MGRM</u>

Mr. Tang is the principal owner of Tang Capital Partners (hereinafter the "Fund"), and he formerly worked with Appellant Brokaw. **[R6830; R6828]**. The Fund owned 7,865,826 shares of MGRM by December 10, 2004 with an average cost basis of $1.3057. **[R796]**. The Fund also owned 18,166,827 CVR's in MGRM with an average cost basis of $0.2357. **[R797]**. Mr. Tang's strategy included a hedging component or arbitrage strategy, and his objective was to sell his long MGRM common stock position by the end of the pricing period to avoid being exposed on either side of the hedge. **[R6855-6856; R798]**. As the evidence showed, other asset managers had similar arbitrage strategies in MGRM. **[R763-768]**. At the start of the pricing period, the Fund owned 2,955,917 shares of MGRM **[R796]** as the Fund had previously sold 4,864,400 shares in the period from December 28, 2004 to May 18, 2006 **[R796]**.

The June 2010 Hearing Panel Decision erroneously stated "for every penny the VWAP dropped below $2.90, down to $2.02, the value of the Fund's CVR's increased by $185,000 **[R11841]**. The VWAP was never $2.90 on any day in 2006. **[R3089-3100]**. In fact, the VWAP was at $2.02 or below on 72 days out of 95 days in 2006 leading up to the pricing period. **[R3089-3100]**. Mr. Tang's Fund's CVR's increased by $181,668.27 for each penny move in the VWAP until the VWAP was below $2.02 – at that point, there is no additional gain on the CVR's yet there would be a loss on the long common stock position in MGRM. For every penny

that the VWAP fell below $2.02, the Fund would suffer losses on the long stock position that it was holding and trying to sell in an orderly fashion. Based on the size of the long MGRM stock position at the beginning of the pricing period of 2,955,917 shares, for every penny below $2.02, the Fund lost $29,559.17. **[R796]**. Until May 26, 2006, it was possible that the Fund could have received even more shares from MGRM to satisfy the CVR liability thus increasing its potential exposure to a depressed and falling stock price. **[R2572; R759-760]**. This critical fact has been overlooked or intentionally ignored by FINRA DOE and FINRA's Hearing Officer. MGRM's stock price fell to a low of $1.90 on May 19, 2006 **[R770]** which was the first day of the pricing period.

Accordingly, Mr. Tang's Fund had no incentive to cause any fall in the MGRM stock price below $2.02. First Mr. Tang and the Fund sold 4,864,400 shares of MGRM leading up to the pricing period, and they were very aware of the times that MGRM's liquidity was most prevalent. **[R796]**. Second, as one of the brokers for Mr. Tang's Fund, Mr. Brokaw did not formulate any strategy in connection with MGRM. He was merely conveying some of the market orders from Mr. Tang's Fund to the sales-traders at DBSI. Third, the June 2010 Hearing Panel Decision overlooked or ignored the testimony of Thomas Lombardi, another registered representative at a different FINRA member firm who took some of Mr. Tang's Fund orders in MGRM at another FINRA member firm, who testified to the abundance of liquidity in MGRM in the morning at the start of the trading day and late in the day near the close. **[R1532-1533]**. The June 2010 Hearing Panel Decision plainly ignored the well-reasoned decision by Mr. Tang to enter market orders to sell at the open and near the close based on increased liquidity at these times. This knowledge was acquired by Mr. Tang while selling 4,864,400 shares of MGRM leading up to the pricing period. **[R796]**.

(C) Errors of Fact in the NAC Decision

In the NAC Decision, the following statement was made:

> "At the end of the three trading days, Brokaw's second sales assistant, Daniel Aliperti ("Aliperti"), prepared a "booking ticket" that combined KT's morning and afternoon sales and falsely indicated that KT placed the Fund's orders directly with a Deutsche Bank sales trader when, in reality, KT placed the orders directly with Brokaw."

(Emphasis Added) [R012481] The evidence contradicts the finding that Brokaw's client, Mr. Tang, placed each of the six orders at issue directly with Mr. Brokaw. Mr. Brokaw's sales assistant Will Ewing placed the second client order on May 19, 2006 **[R5242]**, Mr. Ewing also placed the morning order on May 22, 2006 **[R5259]**, Mr. Ewing also placed the afternoon order on May 22, 2006 **[R5270]**, and Mary Meyer, another DBSI registered representative, placed the morning order on May 23, 2006 **[R5288]**. Both Mr. Ewing and Ms. Meyer were registered representatives and employees of DBSI at the times in question. It is true that Mr. Tang previewed the afternoon order on May 19 to Mr. Brokaw in the morning, but contrary to any nefarious purpose behind that disclosure, the evidence is clear that Mr. Tang was traveling from the West Coast that day and he merely wanted Mr. Brokaw to know in advance about his orders since he was coming to New York and would be in flight. **[R06862-6863].** The NAC Decision's factual holding that Mr. Brokaw placed all six orders in question with the DBSI sales traders is simply not true.

The NAC Decision also seeks to place a burden on Mr. Brokaw to conduct an inquiry to determine the legitimacy of the market orders placed by Mr. Tang. The NAC Decision falsely alleges that DBSI terminated Mr. Brokaw as a result of Mr. Brokaw executing trades in MGRM for one institutional customer (Tang) on three successive trading days in May 2006. This is

factually incorrect as Brokaw did not actually *execute* any trades. All of the trades were executed by DBSI's trading desk and were transmitted to that trading desk by DBSI sales traders Jenner Watson and David Zitman. **[R5659-5660; R7255; R5248; R5676; R5269; R6172; R5270; R5280-5281; R5284]**. At DBSI, Mr. Brokaw lacked the ability to execute any orders – he would only transmit client orders through the sales-traders who, in turn, conveyed the orders to the position traders.

The basis of the NAC Decision is that Mr. Brokaw failed to conduct an adequate inquiry into whether Mr. Tang's instructions to sell MGRM stock were for a manipulative purpose in violation of NASD Rule 2110. The NAC Decision is factually flawed. First, as reflected elsewhere in the NAC Decision, Mr. Brokaw was aware of the following facts: (1) Mr. Tang was bearish on MGRM due to a cash shortage and the Pfizer transaction that Mr. Tang testified would be a "lethal cost" to MGRM **[R06863-6864; R12488]**; (2) Mr. Brokaw was aware of how the CVR's were going to be priced as it was a matter of public knowledge **[R08703-8754]**; (3) Mr. Brokaw was aware that the average price for MGRM common stock and the Volume Weighted Average Price ("VWAP") led one to believe that the CVR's could be fully valued or close to fully valued at the end of the pricing period **[R09265-9276]**; (4) Mr. Brokaw gave an in-depth explanation of his opinion of what was likely to happen to the MGRM stock price during the pricing period to Ms. Watson on May 19, 2006 to make sure that DBSI did not position the stock in inventory due to the expected selling pressure. **[R10672-10679]**. Ironically, DBSI's traders who executed the sell orders did not follow Mr. Brokaw's warning and they took the positions into inventory on May 22 and May 23. **[R 10995-11054]**

It is not clear what FINRA Enforcement expected Mr. Brokaw to do. Mr. Brokaw informed the sales-traders of the pricing period for MGRM's CVR's and he merely

communicated some of the market orders at issue to the sales-traders to be executed at or near the open and at or near the close. As FINRA's Thurgood conceded in his appellate argument, there is nothing wrong per se in buying or selling securities near the open or near the close of the trading day. **[R012405]**.

As the NAC Decision correctly pointed out, Mr. Tang credibly testified that he had learned from his prior trading in MGRM that this stock had the most liquidity in the beginning and end of each day. **[R012485]**. This view was confirmed by the testimony of Thomas Lombardi, a registered representative at another FINRA member firm who had been questioned by FINRA on-the-record. **[R1532-1533]**. Of crucial importance is the fact that Brokaw had no discretion or prior knowledge concerning whether he would even receive any orders. However, once Brokaw received the market orders on an unsolicited basis, he did have an obligation to seek best execution which he did (as well as the other DBSI registered representatives who transmitted orders on behalf of Mr. Tang) by communicating the market orders to the sales-traders. The NAC Decision currently states that "Brokaw worked these orders through the Firm's trading desk, which executed them at market prices." **[R012487]**. FINRA's DOE argued that Mr. Brokaw had a duty to question the "timing" of the orders placed by Mr. Tang even though FINRA's Mr. Thurgood has conceded that there is nothing inherently wrong with doing trading at or near the opening and at or near the close. **[R012405]**. There is no evidence in the record that supports the notion that Mr. Tang was manipulating the MGRM stock price by placing his orders at that time, and Mr. Brokaw submits he had no basis to believe that a manipulation was occurring.

IV. The Controlling Legal Standards

A. The Alleged Just and Equitable Principles of Trade Violation

The NAC Decision states that when determining whether a registered representative's conduct violates NASD Rule 2110, the SEC has "focused on whether the conduct implicates a generally recognized duty owed to clients or the firm". Citing to In the Matter of Dante J. Di Francesco, Exchange Act Rel. No. 66113, 2012 S.E.C. LEXIS 54 (2012). Under this approach, liability under NASD Rule 2110 can be found in the absence of proving motive or scienter, and a showing of unethical conduct, even if not in bad faith, can be sufficient to establish liability. Using the rationale in the Di Francesco case, the NAC Decision fails to identify what duty Mr. Brokaw breached to either his client (Mr. Tang) or the firm ("DBSI"). In Di Francesco, the registered representative downloaded 36,000 customer names from his former employer at Bank of America Securities, along with their confidential personal net worth information, account numbers and telephone numbers. In reality, Di Francesco serviced approximately 200 client accounts so he had no right or permission to have access to 99.44% of the client accounts he purloined when he took this information to a competitor. Di Francesco engaged in this conduct in violation of his former employer's policies, as well as three written agreements with his employer. Clearly, Di Francesco's conduct was unethical and in violation of NASD Rule 2110.

Mr. Brokaw, on the other hand, was merely communicating a client's market orders to his firm's sales-traders, who in turn, transmitted the orders to DBSI's position traders. This was a routine function in the normal course of business. Mr. Brokaw went further, however, in explaining to the sales-traders the likely selling pressure on MGRM during the fifteen-day pricing period. Although the pricing of MGRM's CVR's were a matter of public record for over eighteen months **[R08703-8752]**, Mr. Brokaw's communications to the DBSI sales-trader Ms.

Watson was meant to put DBSI's position traders on notice of the likely upcoming selling pressure on MGRM. **[R10672-10679]**. DBSI sales-trader Ms. Watson actually thanked Mr. Brokaw for the information and told him, "You are a good person" in connection with the explanation and general heads-up for the traders **[R10674]**. Under the Di Francesco standard, Mr. Brokaw violated no obligation to DBSI and even went beyond his normal duty to alert DBSI's trading desk of the MGRM story. Moreover, under the Di Francesco standard, Mr. Brokaw violated no duty to his client Mr. Tang as he instructed the sales-traders to execute the orders at the market and to act expeditiously in accordance with Mr. Tang's instructions **[R10665; R10694]**. Thus, Brokaw met whatever ethical obligations he had under the Di Francesco standard.

The NAC Decision also states that a broker has a duty to make a "diligent inquiry when confronted with suspicious circumstances surrounding trading activity." Citing to In the Matter of Robert B. Prager, Exchange Act. Rel. No. 519 74, 2005 S.E.C. LEXIS 1558 (July 6, 2005). The Prager case is clearly distinguishable on the facts. In the Prager case, there was a finding of a manipulation of a shell company entitled H&R Enterprises, Inc. (hereinafter "H&R"). H&R had no business operations although it was purported to have interests in the vending and leasing industry. The stock manipulation was orchestrated by Michael Mitton, a Canadian resident, with David Heredia, a Florida stock promoter. The stock price was manipulated from $2.21 to $6.68 over three days in September 1987. The stockbroker, Robert Prager, was given specific orders to buy H&R from one source and sell those very shares to another firm. The trading volume changed from between 500 to 25,000 shares per day to five million shares per day at the height of the manipulation. In addition, as the size of the trading increased, Prager was promised enhanced commissions at $0.06 per share (twice his normal commission). Clearly, in Prager, the activity

was highly suspicious involving pre-arranged trades, large volume, enhanced commissions resulting in a significant 300% rise in the stock price of a company with no business operations. Moreover, Prager was actually acting as the market maker (unlike Mr. Brokaw who did not execute the trades) and Prager maintained no financial information or due diligence file on H&R despite a regulatory obligation to do so.

Mr. Brokaw cannot be compared to Prager under the circumstances of the present facts. The record shows that Brokaw did business with Mr. Tang for years and trading in the dollar amounts on the MGRM trades was neither enormous nor remarkable compared to other trading by Mr. Tang. For example, in one week earlier in 2006, Mr. Tang purchased 750,000 shares of Cell Therapeutics for a cost of approximately $1.7 million **[R08811-8840]**. Clearly, the sell orders that were executed in MGRM involving only 262,000 shares were therefore not remarkable or suspicious on its face. The NAC Decision has already concluded that Mr. Tang's trades were legitimate. **[R012486]**. Similarly, selling near the open and near the close when volume was heaviest, as reflected in the evidentiary record, was not suspicious. **[R012485]**. It actually gave the client the best opportunity to complete the trades. MGRM's stock price did not move in an unusual or suspicious manner and the trades did not have a disproportionate effect on the VWAP **[R012486; R09295-9304]**. The overall size of the trades entered by Mr. Tang at DBSI was just a small fraction of the overall market. **[R10763-10768]**. MGRM was not a thinly traded stock and even the NAC Decision held that the trading through Mr. Brokaw did not have a disproportionate effect on the VWAP which was the metric for the pricing of the MGRM CVR's over a 15-day period. **[R023486] [See R012486, footnote 31** – "We do not draw an inference of manipulative intent from KT's orders being traded near the open and close of the market because the pricing of the MGRM CVR's was based on an equally weighted combination of the VWAP

over the 15-day period. This is in contrast to situations in which marking the close is a manipulative act."]. There is simply no justifiable comparison between Prager's conduct and Mr. Brokaw's conduct.

Similarly, the case captioned In The Matter of Alessandrini & Co., 45 S.E.C. LEXIS 399 (1973) is also distinguishable from the present fact pattern. In Alessandrini, four firms were found to be the only market makers in ACI common stock. The scheme included pre-arranged trading between multiple firms despite the absence of a legitimate market for ACI stock. There was a finding of a stock market manipulation as a result of the scheme. The broker Weiss in Alessandrini was on notice of the potential scheme yet he continued to trade. The SEC found as follows:

> "Instead, he [Weiss] closed his eyes to circumstances indicative of a scheme to create the false appearance of an independent market. He not only continued the quotations in the sheets but was instrumental in getting other dealers to quote the stocks."

Alessandrini, 1973 S.E.C. LEXIS at 404. Effectively, there was the creation of an artificial and false market in Alessandrini.

These facts simply do not exist in the Brokaw case. Mr. Brokaw's client's orders were simply market orders placed during the most liquid time of the trading day to sell at market prices. There was no pre-determined buyer on the other side of the trade. There was no attempt to insert false information in the public markets[1] and in fact, Mr. Tang's trades through Mr.

[1] Manipulation is the creation of deceptive value or market activity for a security accomplished by an intentional interference with the free forces of supply and demand. Smartwood, Hesse Inc., Exchange Act Rel. No. 31212, 1992 S.E.C. LEXIS 2412 (1992); Open market transactions similar to the ones in the present case can be manipulative only if there is an intent to artificially affect the price of the security, and the trades are not for any legitimate economic reason. SEC v. Masri, 523 F.Supp.2d 361 (S.D.N.Y. 2007). So long as the investor's motive in buying or selling a security is not to create an artificial demand for, or a supply of, the security, illegal market manipulation is not established. Chris-Craft Industries, Inc. v. Piper Aircraft, 480 F.2d 341 (2d. Cir.1973). In fact there can be no liability for an open market transaction unless the alleged manipulator injected inaccurate information into the market or created a false impression of market activity. GFL Advantage Fund, Ltd. v. Colkitt 272 F.3d 189 (3d Cir. 2001)

Brokaw's firm, DBSI, represented a very small percentage of the daily volume in MGRM. **[R1079-10784** (Mr. Tang's sell orders in MGRM represented 262,000 shares out of 24 million shares during the pricing period)]. The market in MGRM was vibrant, involved many different broker-dealers **[R11587-11680]** and there is simply no basis to compare the situation in Alessandrini and the conceded manipulation of ACI common stock to the facts in Mr. Brokaw's case.

The NAC Decision imposes a responsibility on Brokaw to act as a gatekeeper relating to the execution of Mr. Tang's Fund's market orders. **[R012489]**. The main support for this proposition is the case entitled, In the Matter of Peter Martin Toczek, 51 S.E.C. LEXIS 781 (1993) wherein the entry of buy orders near the end of the trading day to "defend" the firm's positions in three thinly traded stocks (FHR, SVB, and CLC) was viewed as a violation of the just and equitable principles of trades pursuant to NASD Rule 2110. Like the other decisions cited in the NAC Decision, the Toczek case is clearly distinguishable. In Toczek, the President of the broker-dealer (Toczek) acted as a proprietary trader in entering orders near the close or market on close orders in three stocks wherein his firm already had large positions. Toczek admitted that he was "defending" his existing positions and he understood that the placement of his orders had an effect to keep the price of the selected stocks at a higher price. In the decision, the NYSE concluded that Toczek's actions at or near the close of trading unfairly and improperly influenced the market prices of the relevant securities by either maintaining the market price at, or raising it to, artificial values. See Toczek 1993 SEC Lexis at 786. The stocks involved were all thinly traded and there was an evidentiary finding that the stock prices were improperly influenced. Id at 788.

In the NAC Decision, the NAC concluded that "Brokaw without hesitation communicated KT's requests and failed to heed warnings with respect to these trades." **[R012489]**. As set forth above, the NAC Decision is factually wrong in stating that Mr. Brokaw "communicated" all of the trades to DBSI sales traders **[See Discussion infra, pp. 9-10].** The NAC Decision gave weight in Footnote 35 to a "warning" allegedly given to Mr. Brokaw by sales-trader Mr. Zitman that a large market order executed at the open could cause MGRM's share price to move dramatically. **[R012489]**. The NAC overlooked the cross-examination of Mr. Zitman that proved that he was not a credible witness and he had no basis for this statement. In fact, Mr. Zitman was heard on a tape recorded conversation telling Mr. Brokaw the following:

> "Listen to me, listen to me. The 50,000 shares have no fucking effect on the VWAP. It's trading two million shares."

[R5293]. Ironically, in another taped conversation, the same Mr. Zitman conceded to Mr. Brokaw's sales assistant that he did not know whether MGRM was a $1.00 stock or a $20.00 stock. **[R5261]**. Zitman also conceded he was not familiar with MGRM's volume activity (yet he admitted that volume was the determining factor in price volatility). **[R6174]**. Mr. Zitman's so-called warning to Mr. Brokaw is not credible, and he had no basis for his statement that a 50,000 share sell order could move the stock down dramatically. **[R6174, R5268]**. More revealing, if Mr. Zitman truly was concerned, there is no explanation given by FINRA DOE or in the NAC Decision for the undisputed fact that Mr. Zitman entered the order without even speaking to Mr. Brokaw. **[R6169]**. And, one day later Mr. Zitman called early in the morning to see if there was another similar order from Mr. Tang. **[R5280-5281]**. Finally, the evidence showed that Mr. Zitman lied about the execution of Mr. Tang's orders on May 23 being executed near the close when in fact, they were not done until after the close by DBSI in its own inventory.

[R10717-10718 and R10995-11055]. There would be no legitimate reason for Mr. Brokaw to believe there was anything wrong with Mr. Tang's Fund's sell orders given (1) Mr. Brokaw's disclosures of the MGRM pricing period; (2) Mr. Brokaw's disclosures to the sales-traders of Mr. Tang's and other sellers' general strategies; (3) The execution of the orders; and (4) DBSI's Zitman seeking an order on the third day.

Unlike Toczek, Brokaw was not trading for DBSI, MGRM was not thinly traded and as now conceded in the NAC Decision, the Tang orders were legitimate orders. In fact, there was no evidence introduced that MGRM's stock price was artificially influenced nor is there any evidence of false information being injected into the marketplace.

In Toczek, the proprietary trader intentionally sought to influence the closing price of the stock at issue. In fact, Toczek admitted that he was trying to "defend" his firm's long proprietary holdings. Mr. Brokaw had no interest that he was trying to protect at DBSI. He was also not the trader but rather an individual who passed along some of the Tang trades to his sales-traders. Mr. Brokaw merely had a client who was unwinding a long position in MGRM in an orderly fashion by selling when the volume of MGRM was most active and therefore most liquid. Mr. Brokaw had no discretion over his client's orders, and he had a duty to both DBSI and his client. At all times, he acted in an ethical fashion and there is no basis to allege he violated NASD Rule 2110.

It is fundamental law that a stockbroker is not liable for their customer's misdeeds. In the Matter of Edward Mawod, 1977 S.E.C. LEXIS 1811 (1977). In order to find liability on behalf of the stockbroker, there must be a primary wrong established against the customer first and then the inquiry can turn to what the stockbroker actually knew or had reason to know. Id. at 872. Here, there has been no finding of any wrongdoing by Mr. Tang and his Fund and the NAC Decision concedes now that Mr. Tang's orders were legitimate. **[R012486]**. Mr. Brokaw had no

reason to question Mr. Tang's strategy to sell when MGRM was most liquid in the trading day since Mr. Tang was an experienced seller of MGRM since he had already sold in excess of 4,864,000 shares prior to the start of the pricing period. **[R010790]**. The number of shares being sold was not significant in light of the daily trading volume of MGRM.

The amount of inquiry by a stockbroker varies with the circumstances of the particular case. Kane v. Securities and Exchange Commission, 842 F.2d 194 (8th Cir. 1988). A "searching inquiry" may be required if the trades involve substantial blocks of little known securities, thinly traded, and where the seller's identity is unknown. Id. at 199. None of these facts were present in the Brokaw case. MGRM was a well-known public company and its creation as a result of a merger transaction between Aclara Biosciences, Inc. and ViroLogic, Inc. was a matter of public record. **[R6844-6845]**. MGRM was not a thinly traded stock, and in fact, traded in excess of 24 million shares during the CVR pricing period. **[R010763-10768]**. The Fund's orders at issue totaled a very small percentage of that overall value [1.1%]. **[R010763-10768]**. Mr. Tang was also well-known to DBSI as he had been both a former DBSI research analyst in this industry and a client of DBSI for many years. **[R06829-6831]**. Even the basic strategy was known to both Mr. Brokaw and DBSI that Mr. Tang wanted to unwind his position in MGRM as conceded in the NAC Decision. **[R012487]**. The NAC Decision does not properly weigh this evidence in light of the overall conclusion by the NAC Decision that Mr. Tang's market orders to DBSI were legitimate. Under these facts, Mr. Brokaw does not have a further duty to conduct a "searching inquiry" as set forth in the NAC Decision.

In order to find that Mr. Brokaw violated the just and equitable principles of trade standards set forth in NASD Rule 2110, FINRA DOE needed to show he engaged in bad faith or unethical conduct. **See** In the Matter of Morris Kurz, 1994 S.E.C. LEXIS 853 (1994). In the

Matter of Robert J. Jautz, 48 S.E.C. LEXIS 702 (1987); In the Matter of Samuel B. Franklin & Company, 38 S.E.C. LEXIS 113 (1957). As the SEC has previously stated, disciplinary hearings to require compliance with high standards of commercial honor and just and equitable principles of trade are ethical proceedings by their nature. **See** Matter of Application of Timothy L. Burkes, 1993 S.E.C. LEXIS 949 (1993). In the present matter DOE falsely accused Mr. Brokaw of engaging in manipulating MGRM both as a primary wrongdoer and as aider and abettor and also falsely accused Mr. Brokaw of directing his sales assistant to complete inaccurate order tickets. The NAC Decision overturned the manipulation charge thus leaving DOE with the just and equitable principles of trade violation. In reality, DOE failed to prove, and the NAC Decision lacks the factual and legal support to prove that Mr. Brokaw engaged in an unethical conduct. He breached no duty to either his firm (DBSI) or to his client (Mr. Tang) under the DiFrancesco holding. **See** DiFrancesco discussion supra. To the contrary, he notified the true gatekeepers of the firm, the DBSI sales-traders, of the MGRM story so they would be careful not to position stock in the pricing period while at the same time, ensuring that Mr. Tang's sell orders were complied with. While some of Mr. Brokaw's language was colorful, and even colloquial at times in his discussions with the sales-traders, the evidence is clear that the sales-traders understood all of the Tang orders to be market orders and no false information was ever injected into the marketplace. **[R05659-5660; R06171]**. The NAC Decision confirms that no investors were impacted by Mr. Brokaw nor did Mr. Brokaw breach any obligation to his employer. There is just no support for a finding that his conduct was unethical.

B. The Alleged Books and Records Violation

The NAC Decision affirmed the erroneous finding of the Hearing Panel that Mr. Brokaw failed to ensure the accurate preparation of order tickets reflecting Mr. Tang's sale of MGRM on

May 19, 22, and 23, 2006. The NAC Decision cites to the specific NASD Rule 3110 concerning a requirement for "member firms" as follows:

> "NASD Rule 3110 requires member firms to make and preserve books, accounts, records, memoranda and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by SEC Rule 17(a)-3. The recordkeeping format, medium and retention period shall comply with Rule 17(a)-4... "In turn, Rules 17(a)-3 and 17(a)-4 require member firms to make and keep current certain books and records relating to their business activities, including directing broker-dealers to create and keep memoranda of all brokerage orders, and any instructions given or received from the purchase or sale of securities."

[R012490]. Thus, it is very clear that Rule 3110 imposes a duty on the member firm – which in this case is DBSI. Rule 3110 does not impose a specific duty on Mr. Brokaw. To the contrary, Mr. Brokaw is required to comply with the established practices at DBSI.

As originally set forth in the Wells letter, FINRA DOE changed its theory concerning the books and record violation after the Wells process. FINRA DOE changed the charge from intentional misconduct [Mr. Brokaw supposedly caused the firm records to be inaccurate by giving false instructions to his registered sales assistant] **[R11105]** to a lesser, more negligence-based standard of "failing to ensure the accuracy of the tickets" **[R15]**.

The facts are as follows in simplest terms: (1) The local DBSI manager James Knight, conceded that order tickets could be completed by either the broker, the registered sales assistant or the sales-trader **[R6613]**; (2) Mr. Brokaw testified that the completion of order tickets was one of the key duties of his registered sales assistants **[R7191]**; (3) Both of Mr. Brokaw's registered sales assistants -- Mr. Ewing and Mr. Aliperti -- acknowledged this duty **[R5734; R5948]**; (4) DBSI supervisory management acknowledged that registered sales assistants routinely completed

order tickets and time-stamped them **[R6595; R6675]**; (5) The order tickets introduced into evidence confirmed the established practice that Mr. Brokaw did not get involved in order ticket preparation and DBSI accepted this practice throughout his entire career there **[R1187-1404; R6674]**; (6) The alleged "order tickets" that were inaccurate were in fact "booking tickets" -- not order tickets -- prepared at the end of the day by another registered sales person (Mr. Aliperti) **[R09309]**; (7) In fact, DBSI had accurate records reflecting all trades in MGRM through the sales traders showing how each of the Tang orders were filled. **[R10995-11054]**.

The NAC Decision failed to give proper weight to the established practice at DBSI and the existence of the accurate memoranda required by Rule 17(a)-3 maintained by DBSI for the trades in question.

Clearly, a thirty-day suspension and $5,000.00 fine imposed in the NAC Decision for the alleged books and records violation is excessive against Mr. Brokaw.

V. Exception to the Issuance of Sanctions

The NAC Decision corrected one injustice against Mr. Brokaw by lifting the permanent bar while overturning the finding that Mr. Brokaw was guilty of intentional misconduct in a purported manipulation scheme of MGRM. Mr. Brokaw has been unable to work in the securities industry for over two years while suffering under that erroneous decision issued by the Hearing Panel. Yet, despite this excessive punishment, the NAC Decision imposed a one-year suspension for his alleged violation of Rule 2110. As set forth above, Mr. Brokaw submits that he did not violate NASD Rule 2110 as he did not engage in bad faith, unethical conduct or conduct that violated any principle of just and fair trade. Even the NAC Decision states that there are no specific guidelines to assist NAC in levying this heavy new punishment on Mr.

Brokaw. **[R012492]**. Despite the lack of a specific sanction, NAC decided to "lower the boom" on Mr. Brokaw by fabricating facts to conclude that this is an "aggravated" incident **[R012492]**.

Specifically, the NAC Decision made Mr. Brokaw the "gatekeeper" to judge the legitimacy of the trade orders received from Mr. Tang and NAC concluded that Mr. Brokaw was "indifferent to every sign" that Mr. Tang's trades were for possible illicit purposes. **[R012492]**. NAC's reasoning makes little sense in light of its finding that Mr. Tang's trades were legitimate. There would be no other facts that Mr. Brokaw could acquire that would have proven that Mr. Tang's legitimate trades were legitimate. He discussed the selling pressure on MGRM with the DBSI sales-traders Ms. Watson and Mr. Zitman, and nobody involved in the execution of the Tang market orders told him that the trading was improper or illegitimate. The NAC Decision says that the timing of the trades was suspicious but that is contradicted by NAC's own finding that Mr. Tang gave credible testimony that MGRM had greater volume at the opening and closing of the trading day. **[R012485]**. Since the liquidity was greatest at the open and close of the trading day, a seller like Mr. Tang would be inclined to sell off a long position during these times. The record confirms this fact as supported by the testimony of another registered representative, Mr. Lombardi, whose testimony was accepted uncontested. **[R1532-1533]**. Mr. Lombardi was never charged by FINRA DOE for taking Mr. Tang's market sell orders in MGRM yet Mr. Brokaw's entire career has been taken from him.

The NAC Decision further states that other aggravating factors include $725 in commissions allegedly earned by Mr. Brokaw **[R012492]** and his own ownership of the MGRM CVR's. **[R012492]**. The NAC Decision fails to look at the evidence that Mr. Brokaw shared the $725 in commissions with his registered sales team and therefore his personal stake was less. **[R7217]**. Moreover, Mr. Brokaw was a large producer for DBSI and he earned less than $500 on

the trades in question out of over $831,447 in gross commissions in 2006.[2] Moreover, Mr. Brokaw had been a seller of MGRM CVR's for himself and his family prior to the pricing period thus the alleged greed motivation is simply not credible. **[R1067-1068]**. For the record, he had held these CVR's in his family accounts and his account for a long time. **[R11061-11062]**.

If the SEC believes any sanction is warranted, Mr. Brokaw requests that the FINRA Sanction Guidelines be considered closely in light of the following facts:

(1) His unblemished career of 27 years in the industry.

(2) There was no training for brokers on "marking the open" or "marking the close" at DBSI, and he justifiably relied upon the sales traders to ensure that client orders were executed by the equity traders properly.

(3) He advised Ms. Watson of the CVR pricing period on Friday, May 19 to ensure both the sales traders and the equity traders were fully informed.

(4) There was no injury to the investing public.

(5) Mr. Brokaw has provided full cooperation to all regulatory agencies.

(6) No proof of any intentional wrongdoing.

(7) Mr. Brokaw has already suffered tremendous personal losses by losing his employment in the securities industry, losing deferred compensation as a result of DBSI's termination, enduring DOE's false charge that he instructed his sales assistant to put false information on the order tickets from the Wells Notice for over one year and having to respond to state regulators as a result in many jurisdictions.

(8) Mr. Brokaw had incurred significant legal expenses that have been unreimbursed to date.

(9) Mr. Brokaw's pecuniary gain was minimal as described in detail here.

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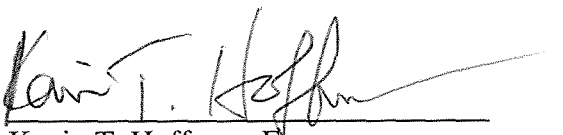
[2] Mr. Brokaw's production history for 2003-2006 showed gross production as follows: 2002 - $2,187,000; 2003 - $1,773,487; 2004 - $1,855,449; 2005 - $1,670,000; 2006 (5 months) - $831,447. **[R7177-7180; R11057-11060]**. Out of the $725 in gross commissions credited to Mr. Brokaw on these trades, it was undisputed that his team received a portion of these commissions. Ms. Meyer received 25% **[R07217]** and his other registered sales assistants also received a portion. **[R0717]**.

CONCLUSION

For the reasons stated above, Mr. Brokaw requests that the NAC Decision finding him in violation of NASD Rules 2110 and 3110 be overruled and the case dismissed with prejudice. Mr. Brokaw suffered greatly due to the overzealous conduct of FINRA DOE and the law and the facts mandate that Mr. Brokaw be exonerated.

Dated: December 3, 2012

Respectfully submitted,



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