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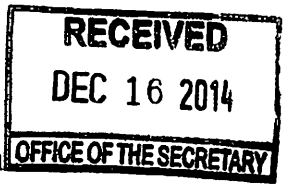

United States of America

Before the Securities and Exchange Commission

Administrative Proceeding File 3-15737

In the Matter of Respondent Thomas C. Gonnella

CROSS-PETITION FOR REVIEW ON BEHALF OF RESPONDENT THOMAS C. GONNELLA

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INTRODUCTION AND FACTUAL BACKGROUND

Pursuant to Commission Rule of Practice 410(b), Respondent Thomas C. Gonnella cross-petitions for review of an initial decision by Administrative Law Judge James E. Grimes, dated November 13, 2014 (the "Initial Decision"), after a week-long hearing conducted in July 2014. The Commission should grant Mr. Gonnella's cross-petition because the Initial Decision makes findings of fact and conclusions of law that are clearly erroneous, and otherwise makes determinations that as a matter of law and policy are important for the Commission to review under Rule of Practice 411(b)(2)(ii).

In 2011, Mr. Gonnella was a [redacted] year-old bond trader at Barclays, dealing in esoteric asset-backed securities. Barclays had an internal aged inventory policy intended to encourage the trading and discourage the holding of securities. For securities held by a trader for longer than seven months, Barclays assessed a fee, subtracted from the trader's book or trading profits for the year, which was just one factor among many (and not an especially critical one) in assessing a trader's bonus. Division Exhibit 1; T 101-04, 146. Such aged inventory charges, however, had no effect on Mr. Gonnella's compensation, nor did he believe that the charges had any such effect. T 474-78, 517, 787-92.

In sum, as bonds approached the deadline when they would trigger aged inventory charges, Mr. Gonnella offered them to Ryan King, a trader at Gleacher and Company, and then purchased them back a short time thereafter. Apart from one text message sent by Mr. Gonnella to Mr. King, and a few conversations that Mr. King initiated by their cell phone, the communications between Mr. Gonnella and King occurred over a Bloomberg instant messaging system, monitored and retained by Barclays. T 221, 248, 335, 345-46, 379-81, 502, 555, 624,

705, 1234.

Upon an internal investigation by Barclays, which had full access to all of the underlying records and messages (except for the cell calls and single text), Mr. Gonnella was terminated. T 720, 1334-35. Barclays reported to FINRA on its Form U5 that Mr. Gonnella had not violated any securities law or regulation, but was terminated for "loss of confidence involving activity related to internal policy for inventory holding periods." Gonnella Exhibit 54; T 1119-20. Mr. Gonnella's managers opposed his termination, but they were overruled. T 869, 1112. Shortly after his termination, Mr. Gonnella was hired by the founder of KGS-Alpha Capital Markets LP on the enthusiastic recommendation of multiple Barclays' executives. T 1276-80, 1318-19. The KGS founder, who testified for Mr. Gonnella as a character witness, believed that employers in the current regulatory climate sometimes terminate employees to deflect scrutiny from themselves, and also to relieve themselves of their obligations to pay the type of substantial deferred compensation that Mr. Gonnella was owed by Barclays. T 1281-83. Similarly, Gleacher terminated Mr. King for failure to follow company instructions, including trading policies, not for violation of securities laws. T 188, 361.

Despite the finding by Barclays that Mr. Gonnella had violated only internal policies (and Gleacher's similar finding about Mr. King), and despite Mr. Gonnella's superlative reputation, the Division of Enforcement initiated an administrative proceeding, alleging that his trades with Mr. King constituted willful violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, requiring that the Division prove that Mr. Gonnella acted with knowledge that his actions were unlawful and intended to violate the law. *See Ratzlaf v. United States*, 510 U.S. 135 (1994) (defining willfulness); *United*

States v. Cassese, 428 F.3d 92, 98 (2d Cir. 2005) (same). Mr. Gonnella's new colleagues at KGS were "blown away" by the Division's charges because they were so contrary to their firsthand impressions of Mr. Gonnella as an "exemplary employee." T 1286.

The Initial Decision feeds the growing cynicism that the SEC uses administrative proceedings to better the odds that overaggressive theories and equivocal inferences will be sustained. *See, e.g., Stilwell v. SEC*, 14-CV-7931 (S.D.N.Y.) (challenging constitutionality of SEC administrative proceedings); Gretchen Morgenson, *"At the S.E.C., A Question of Home-Court Edge,"* N.Y. Times, Oct. 5, 2013. The Initial Decision validated inferences of Mr. Gonnella's liability that even the Division declined to press, and flat-out ignored or marginalized indisputable exculpatory facts that undermined its conclusion. It elevated the workplace misstep of a blossoming star into a violation of law in much the same way that a bulldozer might be used to prune a rose. *See, e.g., St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 562 F.2d 1040, 1048 (8th Cir. 1977) (Section 10(b) was not intended to cover "every imaginable breach of fiduciary duty in connection with a securities transaction").

If vigorous but fair regulatory enforcement promotes compliance, regulatory over-reaching and over-reaction creates a toxic atmosphere of arbitrary enforcement, uncertainty and fear. The Initial Decision may create the illusion of regulatory vindication, but it is the reality of its myopic reasoning that will inure to the detriment of future investors if it is permitted to stand.

ARGUMENT

The Initial Decision is premised on the false notion that Mr. Gonnella engaged in the trades at issue for his own benefit and at Barclays' expense or to its detriment. Initial Decision at 16, 22. But the record supports neither characterization. Mr. Gonnella derived no

personal benefit from the trades, and had no reason to believe that he would derive any benefit. T 474, 787, 792, 477, 517. The Division did not prove otherwise, countering the absence of any evidence of benefit to Mr. Gonnella with only the vague suggestion that aged inventory charges might hypothetically affect a trader's compensation. It is troubling that the Initial Decision devotes such microscopic rigor to conclusions that favor the Division, such as the messages between Mr. Gonnella and Mr. King, but so easily glosses over the Division's failure to show how the conduct truly benefitted Mr. Gonnella personally.

The Division was not required to prove motive, but it needed to prove Mr. Gonnella's willfulness and his intent to violate the securities laws, as opposed to an internal Barclays policy. Mr. Gonnella was a rising star at Barclays, both in monetary performance and integrity. His trading profits through the Fall of 2011 when he was terminated were about $17 million. T 792-93. The aged inventory charges to his trading profits, about $725,000, would not have had any material effect on his compensation, for which the amount of trading profits was only one (and not an especially critical) consideration. Division Exhibit 400, T 792-93. Mr. Gonnella engaged in the conduct at issue in this proceeding because the requirements of Barclays' aged inventory policy were not clear to him (nor to many others), not because he subordinated his employer's interests to his own. More, the Initial Decision's conclusion that Barclays lost $174,000 as the result of the trades – the totality of the purported monetary consequence of selling and then repurchasing the bonds at issue -- was immaterial, represented an alarmingly simplistic view of how real markets operate and true loss and gain are calculated, and ignored the relevance to Mr. Gonnella's state of mind of other bonds which he held *beyond* seven months, and for which he in fact incurred aged inventory charges – and ultimately traded

for profits to Barclays that overwhelmingly dwarfed the purported losses of $174,000. Division Exhibit 11; T 134-35, 137, 141-42, 762, 793, 796, 872, 887-88.

Judge Grimes found it difficult to ignore that some of the trades at issue occurred when Matthew Miller, Mr. Gonnella's supervisor, was on vacation in late August and early September 2011 [Initial Decision at 16-17, 22], but *the Division* essentially ignored that inference, neither pressing it at the hearing nor in its post-hearing submissions. Mr. Gonnella's compliance officer, Louis Giglio, was aware of the trades while Mr. Miller vacationed, as Mr. Gonnella surely anticipated, and Mr. Giglio questioned Mr. Gonnella about them. T 737, 1209, 1213-16, 1219. Mr. Miller himself elevated the issue to his superiors only after a Barclays annual meeting in early November 2011 at which Barclays deemed it necessary to clarify that selling bonds with an eye toward reacquiring them shortly thereafter was not consistent with Barclays policy and might constitute a violation of law under certain circumstances. Division Exhibit 63; T 707-08, 1170-71, 1238-40. More, Mr. Giglio testified at the hearing (without challenge by the Division) that it was Mr. Gonnella who voluntarily reminded him about the trades after the annual meeting in November 2011, and urged Mr. Giglio to revisit the trades with Mr. Miller [T 1241, 1261-62] - an irresistibly exculpatory and undisputed fact that Judge Grimes somehow found it easy to ignore. This case was never about the mouse playing while the cat was away.

Other observations by Judge Grimes unjustifiably put a sinister gloss on tenuous or exculpatory inferences. For example, Judge Grimes found that Mr. Gonnella and Mr. King communicated in "coded language," which was "intentionally vague," to preserve latitude to later claim that they had not firmly agreed in advance to reverse the trades. Initial Decision at 6 n.13.

But the Division did not produce any of Mr. King's "uncoded" communications in other matters to establish that his communications with Mr. Gonnella were out of his norm. The Division thereby failed to rebut Mr. King's own acknowledgement at the hearing to a certain whimsy to his style [*see* T 450 ("It was my just being flippant. You were chained to the desk for large portions of the day, so I tried to amuse myself and others as much as possible")], and Mr. Gonnella's testimony that Mr. King was "a wise guy," "a little offbeat and humorous in a lot of his messages," "sarcastic" and "he's like I'm chained to the desk for hours on a day, so he would try to give humor, or make it more of a humorous place to bring levity." T 551-52, 561, 818. More, Judge Grimes failed to explain how two passing acquaintances like Mr. Gonnella and Mr. King could successfully implement a comprehensible code without any advance discussion that they were initiating it, or why any such code was necessary if it was so easily resorted to and understood in the industry, presumably to the experienced compliance personnel monitoring the messages for whose benefit the purported code was used.

Mr. King's idiosyncrasies aside, Mr. Gonnella initially offered bonds to at least five different counterparties, typically explaining that he was doing so to avoid aged inventory charges with an eye toward repurchasing them – speaking not in any deceptive "code" as Judge Grimes opined, and making those overt overtures months before Mr. Miller's vacation, to which Judge Grimes made so many repeated references. Division Exhibit 21-22; Gonnella Exhibits 5A & 5B; T 39, 487, 749-52, 754, 756, 759-60, 763-66, 837.

Judge Grimes opined that, even *before* any purported agreement between Mr. Gonnella and Mr. King was reached, Mr. Gonnella was "establishing his *bona fides*" and "mak[ing] it worth King's effort." Initial Decision at 16. But that interpretation imposes a

sinister state of mind for which the Commission will find absolutely no support in the record. The totality of the communications that constitute the purported agreement are contained within the recorded messages between Mr. Gonnella and Mr. King, and there is no nefarious attempt to establish anyone's "*bona fides*" or induce Mr. King. Instead, the messages show a young trader expressly seeking to comply with an aged inventory policy in speaking with prospective counterparties, not because it would affect his compensation, but because Barclays had such a policy. T 472-76, 788-90, 803-04. As Judge Grimes acknowledged, the practice of round-trip transactions was common in the industry, and in fact had been previously engaged in by Mr. King's supervisor, who was himself concerned that Mr. King had unadvisedly assumed the risk of the bonds as a favor to Mr. Gonnella without proper assessment of the wisdom of the purchase. T 337-38, 406-09, 772, 777-78, 837. The prevalence of the practice perhaps explains why Barclays saw fit to clarify in November 2011 that the practice did not constitute compliance with the aged inventory policy – another irresistible inference exculpating Mr. Gonnella which Judge Grimes ignored. Division Exhibit 63; T 1238-40. Judge Grimes questioned whether such round-trip transactions served any real economic purpose, an entirely fair question if the focus of the administrative hearing had been academic analysis of Barclays' policy, but which is far afield if not completely irrelevant to whether Mr. Gonnella believed he was implementing his employer's policy (before the annual meeting in November 2011 caused him to reconsider), and not with intent to violate the law.

The Initial Decision goes so far as to impute to Mr. Gonnella an intent to exploit the institutional advantage of his employer at the expense of the smaller Gleacher [Initial Decision at 23], another theory perhaps worthy of academic analysis, but for which no

connection to Mr. Gonnella's state of mind exists in the record – and which is diametrically at odds with the Initial Decision's indispensable conclusion that Mr. Gonnella acted to further his own interests at the *expense* of Barclays, not in its support. Judge Grimes spared no incriminating inference against Mr. Gonnella whether or not supported by the record, pressed by the Division, or consistent with the theory of the Judge's own finding of liability.

Especially troubling was the Initial Decision's reliance on authorities not at all cited by the Division, which itself seemed to have left no stone unturned at the hearing in its aggressive efforts to show that Barclays and Gleacher had been remiss in concluding that their respective employees had done nothing more than violate internal policy. For example, to counter Mr. Gonnella's testimony that price negotiation was atypical in the small universe of traders in esoteric asset-backed securities (explaining why he and Mr. King did not negotiate price, T 545, 566, 776-77), Judge Grimes on his own found and cited commentators from relatively obscure law reviews and an SEC press release in a case based on inapposite facts (effectively introducing expert opinion that Mr. Gonnella was denied an opportunity to rebut). Initial Decision at 23-24. To support the Division's claim that Mr. King's messages were code and not borne of his undisputed whimsy, Judge Grimes on his own found and cited case law about use of language in prior Wall Street cases based on unrelated facts. Initial Decision at 6 n. 13, 18. If the foundation for the Initial Decision were solid, the Judge's own research to support the Division might seem unremarkable, but his efforts seem aimed at filling the obvious gaps in the Division's case and suggest the approach of an advocate, undermining the presumptive deference to which the Judge's findings might otherwise be entitled, and serving to feed cynicism about the Division's increased use of administrative proceedings.

Adding more to that cynicism, Judge Grimes in a pre-hearing ruling validated the Division's cooperation agreement with Mr. King that left open his financial penalty, and relegated the fixing of the amount to the Division itself upon its assessment of the value of Mr. King's testimony in proving Mr. Gonnella's liability. *See* Gonnella Exhibit 35, ¶ IV. Mr. King's cooperation agreement appears to have been modeled on such agreements used by the Department of Justice that leave open the question of penalty as a purported incentive for the witness to testify truthfully. But penalties for cooperating witnesses in criminal cases are not ultimately fixed by their prosecutors, but by Judges appointed pursuant to Article III of the Constitution; the theoretical incentive for truth-telling flows from the sentencer's status as a member of the government's separate and independent Judicial Branch. Here, the entity fixing Mr. King's penalty after the hearing is the same agency (in fact, the very same Division attorneys) prosecuting Mr. Gonnella, creating an incentive to accommodate the Division's agenda, not to tell the truth. It is not surprising that Mr. King's testimony at the hearing was largely incriminating after his testimony at his investigative deposition before his cooperation agreement was largely exculpatory [*see* Division Exhibit 201; T 366-67, 370, 373, 390-91], but Judge Grimes saw no problem with validating just so much of Mr. King's testimony that served to support a finding of liability against Mr. Gonnella, even while acknowledging the overall problems with Mr. King's credibility. Initial Decision at 6 n.13, 27. The practice of deferring the determination of the penalty imposed on a settling respondent until after the settling respondent has testified against a non-settling respondent at an administrative hearing creates inappropriate incentives to provide untruthful testimony, is fundamentally unfair and violates the due process rights of respondents who avail themselves of their right to contest the allegations

against them. As a matter of policy, the Commission should exercise its plenary power under Rule 411(b)(2)(ii)(C) to review the propriety of the Division's use of this new provision in its cooperation agreements.

Also troubling is Judge Grimes' relegation of stock parking, the apparent *sine qua non* of the Division's charges against Mr. Gonnella, to an alternate theory of Mr. Gonnella's liability upon finding that his violation of the Barclays internal aged inventory policy itself constituted a securities fraud. Even then, Judge Grimes sustained the allegation of parking, stretching the concept beyond the contours of the rationale for its prohibition and any workable definition that might clearly advise market participants of what it is they may not do.

Parking is prohibited because it can permit a market participant to maintain ownership of a bad or devalued asset while omitting it from disclosures, and can frustrate the disclosure required by the Williams Act, for example, by concealing a market participant's true ownership of an asset. Thus, the pivotal question is not whether a limited universe of participants in an illiquid market like esoteric asset-backed securities expect that the same assets will be traded back and forth between them – the inevitable dynamic in such a market, but whether the parties agree that beneficial ownership (embracing risk of loss and the right to principal and interest) remains with the seller at the time of a sham sale. *See Yoshikawa v. SEC*, 192 F.3d 1209, 1210-11 (9th Cir. 1999); *United States v. Jones*, 900 F.2d 512, 515 (2d Cir. 1990); *United States v. Russo*, 74 F.3d 1383, 1388 (2d Cir. 1996).

Here, beneficial ownership of the bonds truly passed to Gleacher, as Mr. King's supervisor acknowledged, and Gleacher received principal and interest payments attendant to true ownership. Division Exhibit 401; T 91-93, 337-38, 408-09. To Judge Grimes, the parties'

expectations of likely future reversals of the trades was the equivalent of parking because Mr. Gonnella's call to action was Barclays' aged inventory policy, which resulted in trades that viewed narrowly did not appear to economically benefit Barclays. But transactions become parking only when, independent of motive, they are not "actual, bona fide transactions just like any other in the marketplace." *Yoshikawa*, 192 F.3d at 1219. Any definition of parking that strays from that bright line or indulges post-hoc suppositions or economic analysis would capture a broad swath of transactions lacking the disclosure concerns that underlie the prohibition and unnecessarily confuse market participants as to what they may not do. Here too, Judge Grimes did his own research and cited new authority [Initial Decision at 26], suggesting an overarching agenda other than resolving a dispute between two litigants.

The danger of Judge Grimes' approach is manifested in his parsing of Mr. Gonnella's testimony to find inconsistencies purportedly validating a finding of a guilty state of mind and thus willful intent to violate the securities laws. Even assuming the Judge's misplaced skepticism about isolated bits of Mr. Gonnella's testimony, a conscientious rising star like Mr. Gonnella might rationalize his conduct upon realizing that he inadvertently violated a company policy. Any such rationalizations may be as consistent with consciousness of violating internal policy as willful violation of the law; they do not themselves serve to elevate a workplace peccadillo into a statutory violation, but beg the question of state of mind. Where undisputed facts show that Mr. Gonnella neither derived nor foresaw any financial benefit from the conduct, voluntarily raised the conduct with his compliance officer after Barclays saw the need to clarify its policy at its annual meeting in early November 2011, and expressly explained in messages to Mr. King and others that he was acting to comply with an internal Barclays policy, the

inescapable inference is that Mr. Gonnella did not act willfully and with intent to violate the law. For the same reasons, the record is wholly insufficient to support Judge Grimes' finding that Mr. Gonnella omitted material facts or engaged in deceptive conduct, which is also an essential element of any finding that Mr. Gonnella violated Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

CONCLUSION

The Initial Decision has only a passing similarity to the reality of the conduct at issue. It serves to set a bad and counterproductive precedent that will only confuse market participants and feed the growing perception that the SEC acts arbitrarily and unreasonably. The Commission should grant Mr. Gonnella's cross-petition for review, reverse the Initial Decision and dismiss this matter.

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