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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

BRIEF OF RESPONDENT THOMAS C. GONNELLA IN SUPPORT OF PETITION FOR REVIEW

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INTRODUCTION

This brief is respectfully submitted by Respondent Thomas C. Gonnella pursuant to Commission Rule of Practice 410, 411 and 450, and the Commission's Order dated January 5, 2015, granting Mr. Gonnella's cross-petition for review of an initial decision by Administrative Law Judge James E. Grimes, dated November 13, 2014 (the "Initial Decision"). Upon independent review, the Commission should reverse the Initial Decision because its findings of fact and conclusions of law are clearly erroneous, and because its determinations, as a matter of law and policy, cannot be squared with the record and industry practices.

A hearing conducted in July 2014 established that Mr. Gonnella in 2011 was a 26 year-old bond trader at Barclays Bank, dealing in what were known as 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 they had such an effect. T 474-78, 517, 787-92.

As a limited number of bonds approached the deadline when they would trigger aged inventory charges, Mr. Gonnella offered them to Ryan King, a trader at Gleacher and Company ("Gleacher"), 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 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 access to all of

the underlying records and messages (except for the cell calls and single text), 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, 1334-35. Mr. Gonnella's managers opposed his termination, but 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. KGS-Alpha's 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 their own failure properly to supervise junior employees, and to relieve themselves of having to pay the type of substantial deferred compensation that Barclays owed Mr. Gonnella. T 1281-83. Gleacher likewise terminated Mr. King for failing to follow company policy, not for violating the securities laws. T 188, 361.

Despite Barclays' finding 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 alleged that the 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 proof that Mr. Gonnella had 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 as so contrary to their firsthand impressions of Mr. Gonnella as an "exemplary employee." T 1286.

The Division alleged that Mr. Gonnella willfully defrauded Barclays by engaging in a parking scheme with Mr. King, but its failure to prove willfulness doomed both its claim of

parking, as well as ancillary allegations inextricably intertwined with and predicated on the Division's insufficient evidence of parking. Parking, like any prohibited practice, must be clearly defined so that market participants know what it is that they may not do, and so they are not held to task for conduct that no reasonable person, especially one as highly regarded as Mr. Gonnella, would recognize as illegal. The Division invited a definition of parking that captures conduct not embracing the risk of harm for which the practice is prohibited, and based on inaccurate and unrealistically nefarious interpretations of everyday market activity best left to the supervision of broker-dealers. Thus, the Division repackaged Mr. Gonnella's purported circumvention of Barclays' internal aged inventory policy into willful violations of the antifraud provisions of the securities laws.

Notwithstanding the Division's reliance on Mr. King's testimony that he used coded language in certain of his Bloomberg messages to Mr. Gonnella to disguise parking, the Division introduced none of Mr. King's messages in other contexts to enable a finding that Mr. King's choice of language with Mr. Gonnella was any different from his usual way of communicating, which was indisputably sarcastic. Further, *Mr. Gonnella's* messages to traders other than Mr. King, coupled with Mr. Gonnella's isolated resort to an off-line communication when he truly meant to keep something from his supervisors, established that he did not believe that he and Mr. King were speaking in code in their Bloomberg messages. Further, the convoluted narrative and selective recalls offered by Mr. Gonnella's supervisor at the fact-finding hearing, Matthew Miller, plainly evinced an attempt to protect himself from any claim that he failed to properly supervise Mr. Gonnella, not any genuine belief that Mr. Gonnella had willfully violated the law.

The Initial Decision nevertheless finds that Mr. Gonnella willfully violated the provisions cited above and 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) (noting that Section 10(b) was not intended to cover "every imaginable breach of fiduciary duty in connection with a securities transaction").

This litigation may not be the proper forum to debate the line between vigorous regulatory enforcement which promotes compliance, and regulatory over-reach and over-reaction, which create an arbitrary atmosphere of uncertainty and fear. The latter explains Barclays' expeditious termination of Mr. Gonnella despite support for him among the senior executives in his chain of command. It also explains Mr. Gonnella's supervisor's self-serving rationalizations to protect himself from regulatory action notwithstanding Barclays view that Mr. Gonnella did not violate the law; and his new employer's decisions to hire Mr. Gonnella despite his termination for cause from Barclays, and to testify at the hearing on Mr. Gonnella's behalf against the interests of the agency that regulates his burgeoning business. The Initial Decision may create the illusion of regulatory vindication, but its myopic reasoning will contribute to the unduly retributive

atmosphere of the day, as well as the perception of arbitrariness, and will inure to the detriment of future investors if it is permitted to stand.

FACTUAL BACKGROUND

A. Mr. Gonnella and Barclays' Aged Inventory Policy

In 2011, Mr. Gonnella was a junior bond trader at Barclays [T 546, 788], considered conscientious and fully compliant with Barclays' policies and regulations [T 1223, 1255, 1266-67], and trusted by his colleagues and clients. T 935-38. Mr. Gonnella was so highly regarded that Morgan Stanley offered him a job with guaranteed annual compensation of at least $1 million, but he declined the offer because he liked his work and colleagues at Barclays. T 797-98. Even after the conduct at issue in this matter came to light, senior people in Mr. Gonnella's chain of command did not want to fire him, but Barclays' compliance department left them no choice. T 1319; 859. Barclays' in-house counsel told Mr. Gonnella that, after interviewing his colleagues and supervisors, they were perplexed because the allegations against him were at such odds with the positive perception of Mr. Gonnella's integrity and good character. T 856.

Notwithstanding Mr. Gonnella's termination for cause, he was thereafter hired by KGS Alpha, a prestigious trading firm founded by Levent Kahraman, a long-time former Barclays employee [T 1276-79], in part on the recommendation of Mr. Gonnella's former superiors at Barclays. Those Barclays executives, including Tom Hamilton, Scott Wede and Chris Haid, told Mr. Kahraman in substance that, "Tom is a great guy. Once the compliance officer, compliance guys took over, there was nothing you could do for him." T 859, 1318-1319. Mr. Gonnella's termination for cause from Barclays did not discourage Mr. Kahraman from hiring him for at least two reasons: Mr. Kahraman's view that the regulatory atmosphere over the last five years has

resulted in an increasing number of arbitrary terminations for cause, and that firms sometimes terminate employees to avoid paying deferred compensation. T 1282-83. A significant part of Mr. Gonnella's compensation had been deferred, which he was not paid because of his termination. T 1092-93. After Mr. Gonnella began working at KGS, his colleagues 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. As Mr. Kahraman explained when asked about Mr. Gonnella's honesty, integrity and trustworthiness, "Well, I would take him back today [from his administrative leave upon the Division's filing of its charges]. I don't know what else to tell you, if that's enough. We would take him back today. Or if he decides to go into another business, I would invest in it." T 1286-87.

At Barclays, Mr. Gonnella made markets in esoteric asset-backed securities [T 679, 933-34], fixed income vehicles "collateralized by a specific or discrete pool of underlying assets." T 58. They were known as "esoteric" because they did not fit into other categories of asset-backed securities like mortgage or student loans or credit card debt, and were more of a catchall for other types of commercial obligations. T 66-68, 933-34. The market for esoteric asset-backed securities was highly illiquid [T 214, 245, 938, 943-44, 950-52], with a limited number of potential counter-parties and active traders.[1] T 374-75, 956, 1130, 1385-86. Mr. Gonnella estimated there were a total of ten traders at the time in Bayview bonds, one of the bonds at issue. T 746. Among the traders supervised by Matthew Miller, Mr. Gonnella was by a wide

[1] Within this market, there was typically little or no negotiation over price because parties traded within the prevailing bid-ask spread. T 507, 1164-65. Mr. Gonnella explained at the hearing that the absence of negotiation for esoteric securities was not unusual. T 545, 566, 776-77. Mr. Gonnella's supervisor testified to his belief that negotiation over price was common [T 944], but had not actually traded securities during the three years preceding the trades at issue and had little if any experience trading esoteric securities. T 918-27, 1129-31, 1333, 1380-81.

margin the most profitable: in 2011 alone, up to his termination in early November, Mr. Gonnella's profits were over $17 million, almost double the other traders in Mr. Miller's group. T 790-94.

Barclays' internal aged inventory policy was intended to encourage traders to trade or to "help optimize balance sheet usage through timely turnover of inventory" deemed "stale." Division Exhibit 1. The policy in some respects was clear. For example, the policy clearly stated that, if a trader held a security for more than three months, he would accrue reversible charges against his profits. After seven months, the charge became irreversible and the trader incurred a monthly charge of .5% of the bond's market value. T 102-104, 146; Division Exhibit 1. By definition, complying with the policy would mean avoiding the charge. T 788-89, 794-95, 902. In other respects, the policy was not clear. Kapil Agrawal, a Ph.D. employed as an analyst by the SEC and himself a former Barclays trader [T 14-16], concluded, even with the benefit of the Division's investigation of this matter, that Barclays' memorializations of the aged inventory policy provided that the *aged securities* were transferred to management after seven months [T 99-103, Division Exhibit 401], but notwithstanding his credentials and experience, Dr. Agrawal misinterpreted the policy because only the *charge* levied for aged securities was transferred. T 129-38, 601, 966, 1097-99.

In fact, Mr. Gonnella held some positions for far longer than seven months, and sometimes sold such aged securities at substantial gains to Barclays [T 129-38, 134-35, 137, 141-42, 762, 793, 796, 872; Division Exhibit 11, 24], which vastly outweighed any aged inventory charge to his profits. T 887-88. Further, notwithstanding various memorializations of the policy, Barclays found it necessary at an annual compliance meeting in early November 2011 (after the conduct at issue) to explain that a trader did not comply with the policy by selling a security before an aged inventory charge became irreversible, but then reacquiring the security

thereafter. As explained below, that meeting prompted *Mr. Gonnella to flag the issue to his compliance officer*, and prompted Mr. Miller's escalation of the issue to his superiors and ultimately, Mr. Gonnella's termination. Aged inventory charges, however, had virtually no effect on Mr. Gonnella's annual compensation, which was based on a number of factors, including his age, title and tenure with the firm, and whether he supervised anyone. T 474, 787, 792. Mr. Gonnella was not concerned about the effect of aged inventory charges on his compensation because his profits were so substantial. T 477-78, 517.

B. Mr. Gonnella's Dealings with Gleacher's Ryan King

Between May and November 2011, Mr. Gonnella sold and later repurchased twelve bonds from Mr. King, the head trader of asset-backed consumer securities at Gleacher [T 187-88], a regional broker-dealer. Mr. Gonnella and Mr. King never agreed that Mr. Gonnella would later purchase the bonds; Mr. King did not buy all the bonds offered him by Mr. Gonnella [T 521-22; Division Exhibits 20, 23]; they never discussed the price at which the bonds might be later purchased; and Mr. Gonnella always paid market prices for the bonds when he bought them back from Mr. King. T 860-61, 1048. On one of the bonds, Gleacher took a loss after repeatedly asking if Mr. Gonnella intended to purchase the bond and threatening in substance to get him fired if he did not make the purchase. T 634, 639; Division Exhibits 35, 41, 401. Before the trades at issue, Mr. King and Mr. Gonnella had done one trade that Mr. King had initiated. T 207-09. On that occasion, Mr. King expressed interest in trading in esoteric asset-backed securities and picked Mr. Gonnella's brain about an aircraft bond and "how it worked" before purchasing it, and ultimately taking a loss. T 209-10, 238-40. That trade helped establish Mr. King's interest in esoteric bonds and his status as a potential counterparty.

On May 31, 2011, Mr. King was one of at least five traders with whom Mr. Gonnella communicated, soliciting interest in purchasing four bonds issued by Bayview, referred to as "BAYC." The messages said, for example, that Mr. Gonnella "wanted to see if you had any interest in any of the 4 bonds I'm looking to turn over today . . . . just a month end thing, so I think I'll be higher on these bonds later in the wk" (Division Exhibit 22), or that he was "looking to turn these 4 bonds over . . . so if any of them catch your eye, I'd likely sell them cheaper than usual today. And be a higher bid later in the wk" (Division Exhibit 21). T 39, 487, 749-50, 754, 759-60, 763-66; Division Exhibits 21 and 22; Gonnella Exhibits 5A and 5B. Mr. Gonnella did not believe it was unusual to indicate a likely bid shortly thereafter, nor that doing so created any agreement or pre-arrangement. T 837. Because the universe of potential counter-parties in esoteric bonds was so small, it was not unusual to trade the same bonds back and forth with the same counter-parties, but was an inevitable consequence of the limited number of participating counter-parties. T 772, 777-78.

In Mr. Gonnella's email to Mr. King (Division Exhibit 20), he wrote as follows:

> Hey Kinger . . . not sure you've ever traded bayc's , or looked at them, but have 4 small bonds that I'm looking to turnover today for good ol' month end/aging purposes . . . I'll shoot them over. If any look interesting to you or you want take a stab at any, let me know . . . . I like these bonds, own a lot of different bayview mezz/sub position, and would more than likely have a higher bid for these later this wk when the calendar turns . . . .

Whether Mr. Gonnella believed that any particular Barclays employee might review his communications at any particular time, he knew that his various communications with Mr. King (and other counter-parties) were monitored, retained or both. T 221, 502, 555, 624, 1234. Mr. Gonnella nonetheless made clear in communicating with Mr. King and others that his undisguised purpose was to move securities to comply with Barclays' aged inventory policy ("for good ol'

month end/aging purposes"), and that he had an interest in reacquiring them quickly if permitted by circumstances (such as available capital, market price of the securities and a counter-party's continued retention of and willingness to sell them).

When Mr. Gonnella four months later ultimately meant to communicate something he wished to keep from his superiors, he did not use code, but texted Mr. King off-line. T 624-25; Division Exhibit 46. Mr. Gonnella knew that off-line communications violated Barclays' policy [T 588], but believed it was a minor infraction that would not result in any significant sanction given the context of the transaction and text at issue and his exemplary performance as an able trader and conscientious employee. T 912. Further, Mr. King's language in the monitored Bloomberg messages (and Mr. Gonnella's as well) would have been far too transparent to the type of experienced professionals presumably reviewing the communications to be reasonably considered a coded attempt at subterfuge. More, Mr. King at the fact-finding hearing did not even attempt to explain how Mr. Gonnella and he, who had been only passing acquaintances and met only a few times, successfully implemented a comprehensible code without ever indicating to one another beforehand that they were initiating it.

The far more natural inference was that King's claim of coded language meant to disguise pre-arranged agreements was either invented or imagined. For example, King said that he interpreted Mr. Gonnella's initial message as "coded language that he would be wanting to sell the four small bonds, and then buy them back later this week, once it was no longer [May]" [T 220], but Mr. Gonnella unequivocally expressed that intention; it was not code, nor communicated off-line. Even Mr. Miller testified that in Division Exhibit 20, "it looks like [Mr. Gonnella is] trying to – exactly what he says. He's looking to turn over positions for month end/aging purposes." T 973. More, the parties had not agreed to price, and Gleacher was free to sell the

bonds in the interim. T 224. Similarly, Mr. King suggested that Mr. Gonnella's subsequent language in September 2011 expressing interest in the bonds "if you haven't already sold" them was an effort to avoid absolutes and leave room for the view that no agreement had been reached [T 257; Division Exhibit 32], and that Mr. Gonnella's use of words like "maybe," "if you're game" and "most likely" [in Division Exhibits 28] were attempts to "distance oneself away from an actual absolute predefined trade" [T 242, 247], but in fact Mr. Gonnella did not know whether King had sold the bonds, and had no way of knowing without asking in precisely the way he inquired of Mr. King. T 557, 564-65, 568, 574, 583, 827-28. The purportedly coded language could not reasonably have been perceived by even a marginally savvy trader as truly deceptive.

Absent real evidence of an actual agreement, Mr. King claimed that he believed he was not free to market the bonds acquired from Mr. Gonnella based on Mr. King's purported subjective belief about an unspoken understanding that Mr. King's reputation or his ability to trade with Barclays generally would thereby be compromised. T 225, 228-29, 245, 274-75, 317-18, 330. But Mr. King admitted that his impressions were not caused by any conversations with Mr. Gonnella [T 229], or anyone else, nor did he explain why he believed that Mr. Gonnella was sufficiently aware of Mr. King's purported fears to elevate their dealings into a pre-arrangement.

Indeed, it was not Mr. King who was concerned about Barclays, but *Mr. Gonnella* who was concerned about maintaining *his* relationship with Gleacher, one of the few potential counter-parties in the space. Thus, when Mr. King repeatedly asked Mr. Gonnella if and when he intended to buy BAYC-07-4 bonds that Mr. Gonnella had sold him at month's end in August 2011 and which were losing value (questions themselves at odds with a pre-arranged agreement), Mr. Gonnella repeatedly reassured him that he maintained an interest in buying the bonds [Division Exhibits 45 and 46; T 278, 592]. Mr. Gonnella was sufficiently concerned with *his* standing with

Gleacher that he sent Mr. King an off-line text message out of courtesy to Gleacher because Mr. Gonnella feared that his concern about maintaining a good relationship with Gleacher would be construed by his supervisors as too soft and insufficiently cutthroat. T 624, 701, 830, 886, 901. Thus, Mr. Gonnella texted Mr. King that he could choose to buy one or more additional bonds (Mr. King ultimately chose to buy PALS and LBSBC bonds from a proffered list of four bonds); Mr. Gonnella would likely bid on the purchased bonds and the BAYC-07-4 as a "package;" and that Mr. King could use any profits from the subsequent sale of the PALS and LBSBC bonds to mark down the BAYC 07-4s. T 605-06, 614, 633, 688, 767. The Division did not dispute, at least not convincingly, that it was common to mark down one bond and use trades in other bonds to affect profitability. T 622, 838. Further, Mr. Gonnella made the offer without knowing which of the four bonds Mr. King might buy, and thus the ultimate outcome.

In a moment of candor at the hearing, Mr. King testified that, upon learning from Mr. Gonnella in October 2011 that he would buy back a partial of the BAYC 07-4A, he "was happy to divest myself of, what, 60 percent of the position I owned. I was happy because I didn't have anywhere else to go with that bond, so the more I sold, the better." T 274; Division Exhibit 42. Likewise, Mr. King testified that he was relieved when Mr. Gonnella repurchased the LBSBC bond "because the process of divesting myself of these three bonds was beginning, like we had laid out before." T 329. Plainly, had there been a genuine agreement or pre-arrangement, there would have been little reason for Mr. King's relief when Mr. Gonnella opted to make the purchases.

As for Mr. King's comments including that he had "heard [Mr. Gonnella] might be a buyer" [Division Exhibit 35], and that "I've got a BAYC bond with your name on it, maybe, if you're a buyer of that type of thing" [Division Exhibit 40], Mr. Gonnella explained that it was "just

Ryan being Ryan. He is a little offbeat and humorous in a lot of his messages. 'I heard you might be a buyer,' I thought that's Ryan being Ryan, almost like a sarcastic comment there" [T 551-52] . . . "this is sort of the way that he communicates every so often . . . 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 humourous place to bring levity. . . . Kind of being like a wise guy potentially." T 561, 818. Because the Division failed to produce Mr. King's messages in other contexts showing any different manner of expression, it could not truly take issue with Mr. Gonnella's view. Even Mr. King (who wore a nose ring and a bushy beard when he testified) acknowledged a certain whimsy to his style: "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." T 450.

As Mr. Gonnella testified, he did not have any fixed intention to purchase bonds the next day or at any time after selling them to Mr. King, but liked the bonds and wanted to reacquire them depending on his own available capital, movement of the market and other variables. T 802-04. Mr. Gonnella explained that it was not uncommon for market participants to make profits on a position bought and sold in a single day, or even within a few minutes [T 513-14]: "I think that the market moves very quickly, it's a fast paced market. If I say I'll more than likely have a higher bid for this bond, I think I was just trying to establish what I said before, that I liked these bonds and that I think they are bonds that will potentially go up in value. I don't think that's – that I would more than likely have a higher bid is saying that I will have a higher bid." T 497-98. In fact, Mr. Gonnella's trades with other counter-parties executed after Gleacher's initial purchase created additional capital that enabled Barclays' subsequent purchase from Mr. King, and Barclays generated significant profits on trades Mr. Gonnella was able to execute because of the capital raised by the sales to Gleacher. T 866, 1365.

Similarly, in Division Exhibits 31 and 27, Mr. Gonnella was not proposing more parking by referring to the "same situation" or that they "maybe do what we did a few months ago with some of the BAYCs," but instead was proposing that Gleacher could choose from a range of four or so bonds which Mr. Gonnella liked and was not disingenuously trying to unload on an unsuspecting buyer. T 521-22, 533, 809-10. Barclays ultimately interpreted the messages between Mr. Gonnella and Mr. King not as parking, but as Mr. Gonnella dodging the aged inventory policy, an interpretation that was plain, and which Mr. Gonnella made no effort to hide.

C. Mr. King's Supervisor Recognized that Gleacher Had Assumed the Risk of Ownership

After Mr. Gonnella told Mr. King that he might not be able to purchase two bonds bought by Gleacher at the end of August 2011, Mr. King informed his supervisor, Robert Tirschwell, of his transactions with Mr. Gonnella. T 336. Mr. Tirschwell had himself on an earlier occasion directed Mr. King to sell and repurchase a bond to circumvent *Gleacher's* aged inventory charge. T 406-07. Mr. Tirschwell told Mr. King that Gleacher bore the associated risk of owning the bonds,[2] directed Mr. King to research the market for other potential buyers, and called Mr. King an idiot (among other expletives) for buying the bonds. T 338, 409. Mr. Tirschwell directed Mr. King to tell Mr. Gonnella that he needed to purchase the bonds, or that Mr. Tirschwell would inform Mr. Gonnella's supervisor, and Mr. Gonnella would lose his job. T 340, 416-17, 639-41. Mr. Tirschwell directed that Mr. King's sale of the bonds to Mr. Gonnella be routed through inter-dealer brokers, but did not explain why. T 347, 418, 645, 847. Mr.

[2] Mr. Gonnella explained that he typically bought the bonds from Gleacher at a price slightly higher than the price at which he had sold them to compensate Gleacher for having assumed the risk of loss. T 616-18, 634-36, 686-88, 693-95, 861. It was not unusual to compensate a party for assuming risk, which occurred for virtually every bid-offer spread. T 779-82.

Gonnella complied with Gleacher's request without questioning it or believing that Mr. Tirschwell had ordered something illegal, and immediately indicated to Mr. Miller that an inter-dealer broker known as Euro Brokers had been used to purchase Bayview bonds he had earlier sold to Mr. King. T 649-50, 847-48.

D. Mr. King's Changed Testimony After Agreeing to Cooperate

Like Barclays' termination of Mr. Gonnella, Gleacher did not fire Mr. King for parking or any other violation of the anti-fraud statutes, but for "failure to follow company instructions, including certain of the firm trading policies. Something along those lines." T 188, 361. Mr. King never intended to remain in the financial industry [T 425-26], and agreed to settle with the Division rather than contest the charges.

Despite testifying at the hearing to a contemporaneous understanding that the trades with Mr. Gonnella violated Gleacher's policies, Mr. King testified to the contrary at his investigative deposition in this matter in 2012. T 366-67. At the deposition, Mr. King denied being aware of a Gleacher policy that they violated in trading with Mr. Gonnella. T 366; Division Exhibit 201, at 102. Similarly, contrary to Mr. King's testimony at the hearing about a pre-arranged agreement, he testified at his deposition that "simply, [Mr. Gonnella] had some aged bonds. I was buying them. And if he wanted them back, he could buy them." T 370; Division Exhibit 201. Mr. King testified at his deposition to an expectation that Mr. Gonnella would buy back the bonds at issue, but at the hearing that expectation was elevated to the status of an illegal agreement or arrangement that Mr. King had used purportedly coded language to disguise. T 390-91.

In agreeing to testify against Mr. Gonnella, Mr. King agreed to a three-year ban from the financial services industry, a largely symbolic sanction as Mr. King testified that he had

no long-term intention to remain in the industry and no desire to return. T 201, 425-26. While Mr. King agreed to disgorge $24,000 he had made from the trades at issue, his agreement with the Division left open the amount of his fine and provided that it would be determined after the Division had an opportunity to assess the value of his testimony to its case against Mr. Gonnella. T 394; Gonnella Exhibit 35. Mr. King's fine could exceed $125,000, a significant number for Mr. King, whose post-Gleacher work for a start-up company had produced no income. T 178-79.

E. Mr. Miller's Attempt to Insulate Himself from a Charge of Failure to Supervise

Barclays flagged Mr. Gonnella's late August/early September trades with Mr. King as possible parking violations. T 556, 1211. In early September, Mr. Gonnella's compliance officer, Louis Giglio, asked Mr. Gonnella about the trades. Mr. Gonnella told Mr. Giglio that he liked the bonds and repurchased them thinking they would increase in value, not believing it necessary to mention the aged inventory policy insofar as Mr. Giglio had not asked about his motivation in making the trades. T 737, 740-42, 1209, 1213-15. In memorializing Mr. Gonnella's information, Mr. Giglio wrote that "Gleacher deals with many regional counterparties, and the [trading] desk was hoping to get more individuals involved in the bonds." T 1220, 1236-37; Division Exhibit 39. Mr. Giglio took Mr. Gonnella's explanation to a supervisor (not Mr. Miller), who directed Mr. Giglio to close the matter, which Mr. Giglio did. T 1213-15, 1220-21. Mr. Giglio had never had an issue with Mr. Gonnella before, and apart from the trades at issue, had found him conscientious and compliant with Barclays policies and regulations. T 1223, 1255, 1266-67.

Mr. Gonnella testified that he first discussed the trades with Mr. Miller on October 26, 2011, when Mr. Miller asked about his purchase of the LBSBC bond from Mr. King soon after

selling it to him. T 629. Mr. Miller said that the trades did not "look good." T 629. Immediately thereafter, Mr. Gonnella told Mr. King that he might not be able to purchase other bonds that he had sold to him. T 633-34. The next morning, October 27, 2011, Mr. Miller told Mr. Gonnella that on reflection, the trades were okay, but not to do it again, which Mr. Gonnella understood to be selling bonds just before the aged inventory's policy seven-month deadline and then purchasing them from the same counter-party shortly thereafter. T 637-38, 842-43. Mr. Gonnella testified that he did not have another conversation with Mr. Miller about Gleacher, except for his subsequent disclosure to Mr. Miller that a transaction involving Euro Brokers (that Mr. Miller would have seen on his daily report of Mr. Gonnella's trades) was Mr. Gonnella's purchase from Gleacher of a bond that he had previously sold to Mr. King. T 649-50, 847-48.

Mr. Miller's recollection of his conversations with Mr. Gonnella was dramatically different and appeared to be Mr. Miller's manufactured attempt to explain why he took no action until the time of the Barclays compliance meeting in early November at which the aged inventory policy was discussed. Indeed, Mr. Miller did not deny that senior Barclays manager Tom Hamilton told him that Barclays would not have had to terminate Mr. Gonnella had Mr. Miller timely spotted and addressed the issue. T 1112. Mr. Miller said that he first became aware of the trades at issue in late October or early November 2011. T 1031. He recounted a purported conversation in which he asked Mr. Gonnella why he bought the LBSBC bond when Mr. Miller's earlier directive had been to reduce risk. T 1032, 1110-11. Thereafter, Mr. Miller claimed that he reviewed more of Mr. Gonnella's trades, and became aware of earlier trades with Gleacher that appeared to have been executed to avoid aged inventory charges and "smelled" like parking. T 1049, 1053-55.

Mr. Gonnella testified emphatically, however, that he had no such conversation with Mr. Miller about whether his purchase of the LBSBC bond contravened an earlier directive from Mr. Miller about reducing risk, or any conversation about reducing risk relating to Gleacher. T 1330-31. Even Mr. Miller acknowledged that success in reducing risk could not be evaluated on the basis of one purchase, but on a trader's portfolio considered in its entirety. T 853, 1124-26.

In early November 2011, Barclays held its annual compliance meeting, which both Mr. Gonnella and Mr. Miller attended. T 707-08, 1170-71. The speakers explained that traders could not avoid aged inventory charges by selling securities to a counter-party and then buying them back. T 1238-40. According to Mr. Miller, he had been reviewing Mr. Gonnella's trades just before that meeting and had been "struggling" over whether they violated the aged inventory policy. T 1062. Mr. Miller claimed relief upon hearing from Mr. Gonnella at that time that compliance had looked over the August/September trades and had approved them. T 1063-64.

But Mr. Gonnella testified that he *never* told Mr. Miller that compliance had signed off on the August/September 2011 trades. T 1332. In fact, Mr. Giglio testified that it was *Mr. Gonnella* who approached him immediately after the November meeting, told him that Mr. Miller was concerned about the trades that Mr. Gonnella and Mr. Giglio had discussed in September, and asked Mr. Giglio if he would speak to Mr. Miller. T 1241, 1261-62. At that point, Mr. Miller escalated the issue up the chain of command at Barclays. T 1066-67, 1139.

During its internal investigation, Barclays had access to virtually all of the relevant records, including the communications between Mr. Gonnella and Mr. King, except for Mr. Gonnella's off-line text. T 720, 1334-35. Barclays terminated Mr. Gonnella, affirmatively finding that he did not violate any securities statutes or regulations (necessarily including parking, adjusted trading and inter-positioning), and instead reporting on its Form U5 that Mr. Gonnella

was terminated for "loss of confidence involving activity related to internal policy for inventory holding periods." T 726, 855, 1118-21, 1258; Gonnella Exhibit 54. Similarly, despite Mr. Miller's testimony that Mr. Gonnella's trades "smelled" like parking, he expressly signed on to Barclays' representation to FINRA that, "[b]ased on the firm's investigation led by Barclays in-house litigation counsel, Barclays concluded that it was likely Mr. Gonnella structured certain trades for the primary purpose of evading Barclays' aged inventory policy and that he was not forthright during his interview when asked to explain his trades." T 1103-06; Division Exhibit 65.

ARGUMENT

The Initial Decision is premised on three pillars completely contradicted by the record. First, it relies heavily on the false notion that Mr. Gonnella engaged in the trades at issue for his own benefit, pecuniary or otherwise, and at Barclays' expense or to its detriment, and that in so doing he elevated his self-interest above the fiduciary obligation he owed to Barclays. Initial Decision at 16, 22. Second, it finds the indicia of an actual agreement or pre-arrangement from vague, purportedly coded language, even though the communications make the participants' intentions clear, and are completely consistent with the *absence* of any firm pre-arrangement or fixed intention. Third, the Initial Decision bypasses the necessity of proof of parking by finding that Mr. Gonnella breached a fiduciary duty, but the absence of parking, and Mr. Gonnella's belief that he was complying with the aged inventory policy, negates any finding of breach of duty. The record does not support the Initial Decision's conclusions, and more structurally, does not permit the finding of willfulness on which the Initial Decision is predicated.

1. The Record Contains *No Evidence* of Personal Benefit to Mr. Gonnella

The Division cannot fairly argue that Mr. Gonnella derived any personal benefit from the trades, or had a reason to believe that he would derive any financial benefit. T 474, 787, 792, 477, 517, 790-92. 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 theoretically affect a hypothetical trader's compensation. The readiness with which the Initial Decision glosses over the Division's failure to show how the conduct truly benefitted Mr. Gonnella personally is at odds with the rigor with which it scrutinizes other aspects of the case.

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 therefore 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 790, 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 others), not because he subordinated his employer's interests to his own. The ambiguity of the policy was amply established at the hearing [T 973-74, 993-94, 1008-09, 1081, 1084, 1114-15, 1225, 1229], and is antithetical to the purported clarity of Mr. Gonnella's willfulness. His misguided or erroneous belief that the trades furthered Barclays' interests and internal policies is not a proxy for proof that he was acting out of his own self-interest.

More, the Initial Decision's estimation of what Barclays "lost" as the result of the trades – the totality of the purported 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 of Mr. Gonnella's positions in other bonds that 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. That the trades with Mr. King themselves did not generate a profit penalizes Mr. Gonnella merely for making unprofitable trades, and neglects the reality that in an illiquid market with few participants, preserving good relations with counter-parties might be worth more than any short-term "loss" on a particular trade. Further, if some trades were not profitable, it does not speak at all to Mr. Gonnella's intent to defraud his employer; whether Barclays might have had an extra $174,000 if Mr. Gonnella had not made the trades at issue is not relevant to that analysis.[3]

The evidence did not permit the conclusion that Mr. Gonnella willfully violated the law for no tangible purpose and virtually no gain. There is a great incongruity to the conclusion that Mr. Gonnella made willfully false material misrepresentations in order to avoid aged inventory charges that were *immaterial* to him. The Commission should not accept these kinds of incongruities simply to validate a finding of willfulness.

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[3] The proceeds of the sales to Gleacher went into Mr. Gonnella's trading account, were available for additional investments and profits, and Mr. Gonnella earned a profit on trades made as a result of the capital available only because of the sales to Gleacher. T 157-59, 1365. Dr. Agrawal's analysis of what constituted a loss to Barclays neither accounted for the additional capital that Barclays had at its disposal because of the trades, and the additional income that Barclays generated as a result of additional trades, both from profits realized on the trades themselves, and the principal and interest that Barclays earned on those positions. T 159-60, 163-66, 690-91, 864-65, 868.

More, Judge Grimes found it difficult to ignore that some of the trades at issue occurred when Mr. 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. Miller's vacation was incidental and had no bearing on Mr. Gonnella's state of mind; the inference that Mr. Gonnella traded with Mr. King while Mr. Miller was absent and in order to avoid scrutiny is wrong and has no support in the record. Mr. Gonnella's compliance officer, Louis Giglio, monitored and was aware of the trades while Mr. Miller vacationed, and questioned Mr. Gonnella about them. T 737, 1209, 1213-16, 1219. Mr. Miller himself elevated the issue to his superiors only after a 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 prohibited. 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.

2. <u>The Purportedly "Coded" Language</u>

At the very heart of the Initial Decision was the unwarranted finding 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. Despite the readiness which with Judge Grimes accepted the inference of coded Bloomberg messages, the Division produced not one of Mr. King's communications in other matters to establish that his communications with Mr. Gonnella were out of his norm or in

any way "coded." The Division rebutted neither Mr. King's own acknowledgement of 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")], nor 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. The only true inference available to Judge Grimes was that Mr. King's other messages would have shown the same "code" that purportedly employed with Mr. Gonnella, that is, nothing more than a whimsical, tongue-in-cheek manner of expression in an environment that was otherwise staid and mundane.

Mr. King's idiosyncrasies aside, Mr. Gonnella initially offered the 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. More, there was no evidence of any *prior* communications, or even a prior relationship, from which a comprehensible code might have arisen 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, or why any such code was necessary if so easily understood presumably by the experienced compliance personnel monitoring the messages.

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], a manufactured interpretation that imposes a sinister state of mind for which the Commission will find absolutely no support in the record. The Initial Decision's conclusion that Mr. King was acquiring the bonds "at no risk [to Gleacher, Initial Decision at 16]" is likewise contradicted by the evidence of Gleacher's risk and Mr. Tischwell's plainly expressed displeasure with Mr King precisely because he had assumed risk. T 337-38, 408-09. The totality of the communications that constitute the purported agreement are contained within the recorded messages between Mr. Gonnella and Mr. King, which belies any attempt to establish anyone's "*bona fides*." 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. Mr. Gonnella's communications do not "need [an] explanation" [Initial Decision at 17 n.26] because he so plainly advertised his intentions and motivations in the Bloomberg Messages, and then traded consistently with those representations. *See Division Exhibits* 20-22.

More, 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 expressed concern 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 comply with the aged inventory policy – another irresistible inference exculpating Mr. Gonnella which Judge Grimes ignored. Division Exhibit 63; T 1238-40. That the practice of round-trip transactions was not uncommon or extraordinary almost by itself precludes the possibility that Mr. Gonnella was acting with willfulness and the

requisite intent to defraud.[4] There was nothing conspiratorial about it. And as to the inculpatory interpretation of Mr. Gonnella's use of the phrase "most likely" as indicative of his "actual intention to repurchase by the end of the week," [Initial Decision at 18], that "interpretation" is no more than a recitation of exactly what the message says.

Similarly, the Initial Decision [at 18-19] draws repeatedly on Mr. Gonnella's tolerance of Mr. King's "pestering" as proof of an agreement or arrangement that obligated Mr. Gonnella to buy back the bonds he had sold Mr. King. But the more credible interpretation is that, as Mr. Gonnella explicitly said, he *liked* the bonds that he sold Mr. King, and would be interested in purchasing them not out of a sense of obligation, but because he found them attractive investment vehicles. Thus, Mr. Gonnella's "tolerance" and "assurances" to Mr. King did not prevent King from offering them elsewhere, but validated Mr. Gonnella's interest in eventually purchasing them when conditions were more optimal, which is exactly what occurred. There was nothing nefarious about his steps to "mollify" Mr. King.

In support of the finding of a "code," the Initial Decision [at 6 n. 13, 17-18 & n. 26] cites two cases that do not support such a proposition. In *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1219-20 (D.C. Cir. 1989), third-party nominee accounts served to evade disclosure requirements mandating notice when investors accumulated beneficial ownership of 5% or more of equity securities. By disguising the transactions, the defendants evaded the notice requirement, concealed from public investors potential changes in corporate control, and thereby obtained the shares at prices far lower than what they would have paid if the required disclosure

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[4] Judge Grimes likewise 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 the intent to violate the law.

was made. *See id.* More, the circumstantial evidence effectively precluded the defendants' interpretation that the coded comment in an unpreserved phone call ("It wouldn't be a bad idea if you bought Ashland Oil here") was anything other than an attempt to park securities to evade disclosure. *See id.* at 1223-25. Here, of course, the purportedly coded comments occurred in a medium of communications that was not only monitored and retained, but referred explicitly to expressions of Mr. Gonnella's future intent and what he most likely would do.

Likewise, *SEC v. Drexel Burnham Lambert Inc.*, 837 F. Supp. 587, 597-98 (S.D.N.Y. 1993), arose from the criminal violations of the securities laws by "junk bond" pioneers Michael Milken and Ivan Boesky, a complex fact pattern that has little to do with the allegations here, and in which the engineers of the scheme used Wall Street "argot" to advance it. But that case is a poor comparison for Mr. Gonnella's overtly expressed intentions to buy back the bonds from Mr. King, and Mr. King's responses borne not of Miken/Boesky-esque sophistication, but Mr. King's self-indulgent sarcasm. That case is as exaggerated a metaphor for this one as the Division's invocation of Bernard L. Madoff [T 1287-88], perhaps the biggest fraudster who ever lived, in seeking to discredit Mr. Gonnella, who failed to comprehend his employer's aged inventory policy – with no concomitant personal benefit.

The Initial Decision imputes 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 there is no evidence in the record connected to Mr. Gonnella's state of mind. As for the Initial Decision's focus on lack of negotiation, Judge Grimes ignored Mr. Gonnella's testimony that lack of negotiation was common in favor of 20 year-old law review articles, not cited by the Division and found by Judge Grimes as

the result of *sua sponte* research.[5] Judge Grimes also gave short-shrift to the indisputable fact that prices of all the trades at issue were within the prevailing bid-ask spread. Initial Decision at 23; T 507, 545, 566, 776-77, 918-27, 1129-31, 1164-65, 1333, 1380-81.

These factors say nothing about Mr. Gonnella's purported "bad faith" [Initial Decision at 23-24], nor do they in any way establish that he traded for his own benefit and self-interest. In short, 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.

3. The Initial Decision's Flawed Discussion of Parking

No less troubling is Judge Grimes' relegation of stock parking to an alternate theory of liability upon finding that violating the aged inventory policy itself amounted to securities fraud. The Initial Decision sustained the allegation of parking and stretched the concept far beyond the rationale for its prohibition and any workable definition that might clearly advise market participants of what they may not do. Parking is prohibited because it can permit traders to maintain ownership of bad or devalued assets while omitting them from disclosures, and can frustrate the disclosure required by the Williams Act, for example, by concealing the trader's true market position. *See, e.g., First* City, 890 F.2d at 1223-25. Thus, the pivotal question is not

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[5] The Initial Decision's reliance on certain authorities not cited by the Division was puzzling. 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 found and cited commentators from relatively obscure law reviews and an SEC order 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. If the foundation for the Initial Decision were solid, the Judge's research to support the Division might be unremarkable, but his efforts seem aimed at filling 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.

whether a limited universe of traders in an illiquid market like esoteric asset-backed securities inevitably expects that the same assets will be traded back and forth between them, 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. Russo*, 74 F.3d 1383, 1388 (2d Cir. 1996); *United States v. Jones*, 900 F.2d 512, 515 (2d Cir. 1990).

In *Yoshikawa*, 192 F.3d at 1210-11, a broker engineered a series of five round-trip trades between his firm's inventory account, his personal trading account and his retirement account, usually with minor price differentials. The NASD found that the transactions were a sham to "conceal true ownership" of the stocks and impermissibly prevent the firm from falling below net capital requirements, thus misrepresenting the true state of the firm's finances. The Ninth Circuit distilled parking to three core elements: "(1) a pre-arrangement to sell and then buy back securities [to conceal true ownership]; (2) on the same, or substantially the same, terms [thus keeping the market risk entirely on the seller]; (3) for a bad-faith purpose, accomplished through a sham transaction in which nominal title is transferred to the purported buyer while the economic incidents of ownership are left with the purported seller.". *Id.* at 1211. However, the only trade that possibly met the definition of parking was where the broker admitted that his repurchase was effectuated merely to "return" the shares to the firm's inventory account after a "temporary" sale, which could have indicated a bad-faith pre-arrangement in the broker's mind. *See id.* at 1215.

Elsewhere, in *Jones*, the Second Circuit defined parking as essentially:

> a purported transfer of ownership in securities combined with a secret agreement providing the "seller" with the right to repurchase them at a later date. The 'seller' receives the tax benefits of a loss realized by the 'sale'; the 'buyer' is compensated for the 'cost of carrying' the securities. Since the agreement to resell ensures that

> the 'seller' never loses control of the securities, the government considers 'parking' a form of tax and securities fraud.

900 F.2d at 515. Thus, even though parking is not explicitly proscribed by statute, if done in a certain way, it can violate certain statutory provisions the same as any fraudulent scheme might, even if not addressed in explicit terms. *See United States v. Bilzerian*, 926 F.2d 1285, 1299-1301 (2d Cir. 1991) (upholding conviction premised on parking relating to reporting requirements of beneficial ownership). Because parking serves to conceal true beneficial ownership, it rises to the level of a statutory violation if it implicates the sorts of representations that bear on investment decisions.

Similarly, in *Russo*, the Second Circuit upheld a conviction for securities fraud premised, in part, on parking in the service of a larger stock manipulation:

> Petrokansky engaged in another method of "hiding" *Lopat* and *EAS* stock from the market. On instructions from Russo, Petrokansky placed *Lopat* or *EAS* with customers by guaranteeing them that K&C would buy the stock back in one or two weeks at a small profit of an eighth or sixteenth of a dollar per share. When the time came to buy back the stock, Petrokansky presented sell tickets reflecting a higher price than the customer had paid or than was posted on NASDAQ that day. Petrokansky would often immediately park the same stock with a new customer.
>
> Parking *Lopat* and *EAS* stock accomplished the same purpose as making unauthorized placements: it kept *Lopat* and *EAS* off the market and out of K&C's account. In so doing, the parking created a false impression of *Lopat*'s and *EAS*'s vitality on the market and freed K&C from responsibility for the stock. Unlike the unauthorized placements, however, the parking bore a cost to K&C, namely, the profits it paid out to the customers who held the stock.[6]

74 F.3d at 1388. *Russo* did not precisely define parking, but affirmed because the broker-dealer employer of the defendants "perpetrated a fraud on the market by divorcing the financial risk of owning *Lopat* and *EAS* from legal ownership of the stock." *Id.* at 1393.

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6 *Russo* noted that parking may or may not rise to the level of a 10b-5 violation, but if even certain forms of parking do not constitute a 10b-5 violation, then surely Mr. Gonnella's conduct does not. 74 F.3d at 1393.

The evils and risks of parking are apparent on the face of these cases in ways that are not present here. While Mr. Gonnella may have violated Barclays' aged inventory policy, beneficial ownership of the bonds and the risk of loss 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, beneficial ownership did not *really* pass to Gleacher, because of the arrangement to repurchase the bonds, but that reasoning has it backward: Judge Grimes was supposed to assess the existence of a pre-arrangement by the indicia of transfer of ownership, not vice-versa. Mr. Gonnella did not defraud the market or the investing public because the economic incidents of ownership in fact passed to Gleacher. Accordingly, his conduct does not constitute parking.

This case is decidedly unlike *Bilzerian* and the parking scheme devised therein, relied on by the Judge Grimes [Initial Decision at 21, 26-27]. There, because the stock price of parked securities fell before the defendant could repurchase them, as he had agreed to do, he falsely generated $250,000 in commissions to compensate his counter-party, and used false invoices for services that were never rendered, *not* above-board transactions at prevailing market prices that actually reflected a shift in ownership and risk. *Id.* at 1290-91. Further, the defendant engaged in the scheme for the purpose of defrauding investors and/or the SEC and IRS, not for the purposes of complying with an internal policy on aged inventories or anything else. Mr. Gonnella's conduct does not begin to approach the fundamentally corrupt conduct outlined in *Bilzerian* and other cases Judge Grimes relied on in his discussion of parking.[7] Initial Discussion

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[7] In *Hurst*, for example, the defendant engaged in a plainly convoluted and systematic scheme to park securities in order to deceive and defraud customers and investors. One of the indicia of the scheme, which he *admitted* to, was that he dictated prices for certain trades that, *unlike* here, were not executed at prevailing market prices, which "did not indicate or reflect the actual market value of those securities." It

at 26-27. If Mr. Gonnella's conduct can only be said to violate the securities laws by strained reference or analogy to the incalculably more egregious and serious conduct described in cases like *Bilzerian* or *SEC v. Zandford*, 535 U.S. 813 (2002) [Initial Decision at 15, 22], the conclusion is as flawed as the comparison.

To Judge Grimes, the parties' expectations of future reversals of the trades equated with 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 as *Yoshikawa* noted, merely because a transaction is entered into with a particular purpose in mind – whether that motive is to avoid an aged inventory charge or to prevent net capital levels from meeting a certain threshold – does not mean that the transaction is illegitimate, illegal, or that it constitutes parking. 192 F.3d at 1219. "There is nothing dishonorable about such conduct; if there were, securities trading could never take place." *Id.* The Initial Decision, however, appears to find Mr. Gonnella's bad faith [at 26] merely because the aged inventory policy spurred the trades. The transactions become parking, however, only when, independent of motive, they are not "actual, bona fide transactions just like any other in the marketplace." *Id.* As in *Yoshikawa*, Mr. Gonnella's repurchases, absent proof that they were not genuine, bona fide trades in which Gleacher shouldered the risk and benefits of ownership for the periods in which it held the bonds, are not illegitimate. Any definition of parking that strays from that bright line would

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was for that reason that the lack of negotiation was important there, because it was *not* endemic to the nature of the securities, unlike the market for esoteric asset-backed securities. *See id.* Further, as a result of the scheme, Hurst obtained excessive compensation which totaled nearly $700,000. Likewise, in *Lynch*, the defendant had been criminally convicted after employing a parking scheme to evade net capital requirements, and manipulate the prices of the traded securities, which he then fraudulently marked up to unsuspecting customers of the broker-dealer, and likewise engineered the scheme to profit nearly $500,000. The only thing these kinds of parking cases reveal is how far the facts here stray from the kinds of securities fraud the Commission has previously seen as worthy of enforcement.

capture a broad swath of transactions lacking the disclosure concerns that underlie the prohibition and would needlessly confuse traders and hinder legitimate trading.

4. Mr. Gonnella Did Not Violate A Fiduciary Duty

Conceptually, Judge Grimes' discussion of the *necessity* of parking - the finding that Mr. Gonnella's purported breach of fiduciary duty amounts to securities fraud irrespective of whether he illegally parked securities [Initial Decision at 21-22, 24-25] - is as flawed as his substantive discussion of parking itself [Initial Decision at 25-27]. A purported breach of fiduciary duty involving only strict compliance with an employer's internal policy (especially *where the employer expressly found no violation* of the securities laws) is not sufficiently material to come within the reach of the securities fraud statutes, as courts have rejected the principles on which the Initial Decision's finding of liability are premised.

Employment disputes and mundane violations of internal policies do not become securities fraud merely because they occur at a broker-dealer, as the antifraud provisions are not mechanisms to police activity that implicates an employer and its employee's compliance with internal policy. *See Rodriguez-Ortiz v. Margo Caribe, Inc.*, 490 F.3d 92 (1st Cir. 2007). Section 10b was not designed to regulate or govern corporate management or mismanagement, s*ee Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Acito v. IMCERA Group,* 47 F.3d 47, 54 (2d Cir. 2005), nor was it intended to reach issues and conduct relating to employee compensation or incentives, which are not proper subjects of a Section 10b prosecution. *See Acito*, 47 F.3d at 54. Further, Mr. Gonnella's desire to avoid aged inventory charges is not a proper basis for a violation of Section 10b, which does not require that individuals or entities that enter into securities transactions freely disclose their underlying motives or subjective beliefs

about entering into the transaction. *See Alabama Farm Bureau Mut. Casualty Co. v American Fidelity Life Ins. Co.*, 606 F.2d 602 (5th Cir. 1979).

Likewise, Section 10b was not intended to bring within its ambit "every imaginable breach of fiduciary duty in connection with a securities transaction." *St. Louis Union*, 562 F.2d at 1048; *see also Zandford*, 535 U.S. at 825 n.4 (noting that breadth of "in connection with" language "does not transform every breach of fiduciary duty into a federal securities violation"); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-78 (1977) (holding that Section 10b does not encompass breach of fiduciary duties without a showing that investors were deceived by the conduct at issue). Instead, the primary purpose of Section 10b is to protect the investing public from trading practices inimical to fair dealing. *See Bilzerian*, 926 F.2d at 1297; *Travis v Anthes Imperial, Ltd.*, 473 F.2d 515 (8th Cir. 1973); *Fox v Prudent Resources Trust*, 382 F. Supp. 81 (E.D. Pa. 1974); *SEC v. M. A. Lundy Associates*, 362 F. Supp. 226 (D. R.I. 1973). Those concerns are not implicated by the facts here.

Even if Mr. Gonnella breached a fiduciary duty owed to Barclays, such violation, on these facts, does not constitute a willful violation of the proscription on securities fraud. That is not to say that liability for securities fraud cannot be derived from an employee's breach of duties owed to an employer, from misappropriation of material information, or from a deprivation of the employee's honest services. *E.g.*, *SEC v. Talbot*, 530 F.3d 1085 (9th Cir. 2008); *SEC v. Clark*, 915 F.2d 439, 443 (9th Cir. 1990); *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981). Those cases evince an independent violation of a regulatory statute in the context of an employee-employer relationship. Here, the Division's complaint wrongly seeks to convert an employee's breach of the employer's internal policy into an independent violation of an external statute. At most, Barclays could have initiated a civil suit for breach of Mr. Gonnella's fiduciary

duty. New York, like other states, has a separate cause of action for breach of a fiduciary duty for aggrieved parties who wish to avail themselves of it. *See, e.g., Grund v. Del. Charter Guar. & Trust Co.*, 788 F. Supp. 2d 226, 248-50 (S.D.N.Y. 2011). But the Division is the wrong plaintiff, and the securities fraud provisions the wrong statutes.

5. The Division's New Spin on Cooperation Agreements

In a pre-hearing ruling, Judge Grimes validated the Division's cooperation agreement with Mr. King that left open his financial penalty, and relegated the determination of that amount to the Division itself upon its assessment of the value of Mr. King's against Mr. Gonnella's. *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 ultimately determined by Judges appointed pursuant to Article III of the Constitution, not by prosecutors. Thus, the theoretical incentive for truth-telling flows from the sentencer's status as a member of the 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. After Mr. Gonnella's hearing at which the Division secured a finding of liability against Mr. Gonnella, the Division determined that Mr. King's cooperation was sufficiently valuable such that he should not be ordered pay *any* civil penalty. *See Order Making Findings and Concerning Civil Penalty and Terminating Administrative and Cease-and-Desist Proceedings*, dated January 28, 2015, *In re Ryan C. King, Respondent*, Adm. Proc. File No. 3-15736. The Division's cooperation agreement with Mr. King is especially unseemly in light of the diametric differences between his testimony at his

investigative deposition at Mr. Gonnella's fact-finding hearing. Mr. King's testimony at the hearing was largely incriminating, after his testimony at his investigative deposition before his cooperation agreement was largely exculpatory, as recounted *supra*. *See* Division Exhibit 201; T 366-67, 370, 373, 390-91. Nevertheless, 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 problems with Mr. King's credibility. Initial Decision at 6 n.13, 17 n. 26, 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. It strikes at the heart of the separation of powers principles enshrined in the Constitution, and impermissibly encroaches on quintessential functions reserved to a separate branch of government, the independent judiciary. In *United States v. Mistretta*, 488 U.S. 361, 381-82 (1989), the Supreme Court found that the "greatest security against tyranny – the accumulation of excessive authority in a single Branch – lies . . . in a carefully crafted system of checked and balanced power within each branch." Those checks and balances are a "self-executing safeguard against the encroachment or aggrandizement of one branch at the expense of another." *Id.*

Here, the Division transgresses this principle by permitting an agency of the Executive Branch to investigate and prosecute a securities violation *and* to determine a sanction for that violation *after* it has determined whether it is satisfied with the cooperator's testimony. It

effectively "unites the power to prosecute and the power to sentence within one Branch." *Id.* at 391 n.17. The Supreme Court has put it thus:

> It is this concern of encroachment and aggrandizement that has animated our separation-of-powers jurisprudence and aroused our vigilance against the "hydraulic pressure inherent within each of the separate Branches to exceed the outer limits of its power." Ibid. Accordingly, we have not hesitated to strike down provisions of law that either accrete to a single Branch powers more appropriately diffused among separate Branches or that undermine the authority and independence of one or another coordinate Branch. . . . [W]e have upheld statutory provisions that to some degree commingle the functions of the Branches, but that pose no danger of either aggrandizement or encroachment.

Mistretta, 488 U.S. at 382. As a matter of policy, the Commission should not sanction the Division's use of this new provision in its cooperation agreements. In an atmosphere where the Division of Enforcement is already using administrative proceedings to garner every possible institutional advantage, it is important to preserve safeguards that ensure and lend the appearance of fundamental fairness. Mr. King's cooperation agreement is a good place to start.

CONCLUSION

The danger of Judge Grimes' approach is manifested in parsing Mr. Gonnella's testimony to find inconsistencies purportedly validating state of mind consistent with the 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, and do not themselves serve to elevate a workplace peccadillo into a statutory violation. Where 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. For similar reasons, the Commission should reject the Initial Decision's findings [at 29-30] that Mr. Gonnella aided and abetted the creation of false records under Section 17(a) of the Exchange Act. The Division's failure to prove the underlying securities violations, including that Mr. Gonnella illegally parked securities with Gleacher, precludes the finding that he aided and abetted the records violation under Section 17(a) and the rules promulgated thereunder, and that the records were false or incomplete. 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 reverse the Initial Decision and dismiss this matter.

Dated: February 4, 2015

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[redacted]

Counsel for Respondent Thomas Gonnella

United States of America
Before the Securities and Exchange Commission

Administrative Proceeding File 3-15737
In the Matter of Respondent Thomas C. Gonnella

Rule 450(d) Certificate of Compliance

I, Jeremy B. Sporn, counsel for Respondent-appellant Thomas C. Gonnella, hereby certify in accordance with SEC Rule of Practice 450(d), that the foregoing brief complies with Rule 450 because it contains fewer than 14,000 words. Using the Microsoft Word program, I have performed a word count, which indicated that the brief, exclusive of this certification, contains 11,668 words.

February 4, 2015

Jeremy B. Sporn, Esq.
[redacted]

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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

MOTION OF RESPONDENT THOMAS C. GONNELLA
FOR ORAL ARGUMENT IN SUPPORT OF PETITION FOR REVIEW

PLEASE TAKE NOTICE that, pursuant to Commission Rule of Practice 451, in connection with the Commission's consideration of Respondent-appellant Thomas C. Gonnella's petition for review of an initial decision by the hearing officer, Mr. Gonnella hereby moves for and respectfully requests oral argument before the Commission. The Commission's determination and decisional process will be significantly aided by oral argument.

Dated: February 4, 2015
New York, New York

Andrew J. Frisch
The Law Offices of Andrew J. Frisch
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Counsel for Respondent
Thomas C. Gonnella

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February 4, 2015

BY FEDERAL EXPRESS

The Honorable Brent J. Fields
Office of the Secretary
Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: In the Matter of Respondent Thomas C. Gonnella
Administrative Proceeding File No. 3-15737

Dear Secretary Fields:

On behalf of Mr. Gonnella and pursuant to the Commission's Rules of Practice, I am enclosing an original and three copies of (1) Mr. Gonnella's brief in support of his petition for review from the hearing officer's initial decision, and (2) Mr. Gonnella's motion for oral argument in support of his petition for review. Counsel for the Division of Enforcement has been served electronically. Thank you for your consideration.

Respectfully submitted,

Jeremy B. Sporn

Enclosures