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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 OPPOSITION TO THE DIVISION OF ENFORCEMENT'S PETITION FOR REVIEW

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Respondent Thomas C. Gonnella respectfully submits this memorandum in opposition to the Division of Enforcement's Brief in Support of Petition for Review, filed on February 4, 2015, and in accordance with the Commission's Order and briefing schedule, dated January 5, 2015. In its brief, the Division promotes an anachronistic view of the conduct involved, of Mr. Gonnella, and of the likelihood of *any* future misconduct – all of which cannot be reconciled with the record, the law and basic fairness. The Division's apparent dissatisfaction with the length of the industry bar imposed (one year) is far more reflective of the cynical need to validate the time and attention it has relentlessly devoted to this matter than to the intrinsic wrongfulness of the conduct involved, its outward effects, the need to deter similar violations or anything that Administrative Law Judge Grimes might have overlooked or sold short. Indulging or accommodating the Division's cynicism may only feed the industry's growing sense that the SEC has begun acting arbitrarily in its legitimate efforts to regulate, thereby undermining confidence in its work, and creating counter-productive results. On the other hand (assuming the Commission rejects Mr. Gonnella's cross-petition from the adverse ruling against him), leaving unmolested the penalty imposed by ALJ Grimes will vindicate a measured regulatory approach, and one that achieves some balance in preventing and deterring misconduct, but not becoming unduly punitive and overbearing in stifling legitimate market activity.

In the case the Division cites that purports to offer the appropriate standard of review, the Division appealed not the length of the suspension (a permanent bar), but the ALJ's initial decision to not extend the permanent bar to association with a municipal advisor or nationally recognized statistical rating organization. *See In Re John W. Lawton*, Investment Advisors Act Rel. 3513, at 1 (Dec. 13, 2012) [Div. Br. at 12]. There, however, the ALJ had limited the scope of the industry bar not on the substantive grounds that it was not in the public interest, but out of concern that it would have had impermissible retroactive effect and thus implicate *ex post facto* protections. While the ALJ in *Lawton* concluded that such a bar could not be given retroactive effect to sanction conduct that occurred prior to Dodd Frank, the Commission concluded otherwise as a matter of law. Thus, the Division's reliance on the independent review of the *breadth* of the sanction and the purely legal question raised in *Lawton* fails to apprehend the more deferential review extended by the Commission to a hearing officer's determination of penalty.

Viewing *Lawton* or *In re Johnny Clifton*, Securities Act Rel. No. 9417, at 19-22 (July 12, 2013), another similar case, as precedent for the Commission's increase of a purportedly impermissibly lenient penalty is highly dubious. The Division does not appear to cite any case where the Commission has rejected the length of the penalty imposed by the ALJ who presided over the hearing, and in its stead imposed a more severe sanction. It is quite different when the Commission *affirms* a permanent bar imposed by the hearing officer, [e.g., *In Re Philippe N. Keyes*, Exchange Act Rel. No. 54723 (Nov. 8, 2006); *In Re Alfred Clay Ludlum*, Securities Act Rel. No. 36298 (July 11, 2013); *In Re Mayer A. Amsel*, Exchange Act Rel. No. 37092 (Apr. 10, 1996); Div. Br. at 13-14, 20], than when (if ever) it imposes one in the first instance only after rejecting a more lenient sanction imposed by the ALJ. If the Commission has done so, entirely different circumstances were sure to have been present. And if the Commission has not done so, this case is hardly the place to start.

The posture of this case is important because the Division's argument is composed almost exclusively of rulings made by the Commission in rejecting the appeals of *respondents* who argued that their penalties were too severe. For example, where the Division purports to diminish youth or a previously clean record as mitigating factors, or that other [non-defrauded] clients continued to stand by and support the respondent, it was the respondent appealing the length or severity of his industry bar and offering those factors as mitigating considerations. *See Keyes, supra*; *Ludlum, supra; In re Sherwin Brown & Jamerica Financial, Inc.*, Investment Advisors Act Rel. No. 3217, at 7 (June 17, 2011); *In Re James C. Dawson*, Investment Advisors Act Rel. No. 3507, at 6-7 (July 23, 2010); *In re Scott Epstein*, Exch. Act Rel. No. 59328, at 21 (Jan. 30, 2009); *see also* Div. Br. At 18-20. When the respondent on appeal before the Commission claims that an "unblemished record"counsels for a lesser sanction, the Commission is in a far different position in observing that such arguments do not favor a lesser sanction than the one already imposed, than if it declared that they should be discarded altogether as considerations in favor of imposing a more severe sanction. *See, e.g.*, *In Re Montford and Company, Inc.*, Investment Advisers Act Rel. No. 3829, at 32 (May 2, 2014).

These kinds of examples are not exceptions; the Division's brief is structured around extending non-controversial principles to new contexts where they are not warranted. Many of the Commission pronouncements that the Division cites or relies upon elsewhere resulted from criminal convictions or otherwise arose from criminal investigations. *E.g.*, *In Re Ross Mandell*, Exchange Act. Rel. No. 34-71668 (Mar. 7, 2014); *Lawton,* supra; *In Re Toby G. Scammell*, Investment Advisors Act Rel. No. 3961 (Oct. 29, 2014); *In Re Jose P. Zollino*, Exchange Act Rel. No. 34-55107 (Jan. 16, 2007); *In re Robert Sayegh*, SEC Rel. No. 118, at (Oct. 10, 1997) [Div. Br. at 14-16, 19-20]. The fact of a criminal conviction alone makes the conduct in those cases *per se* more egregious than here, where no criminal charges were even pursued, and the existence of a criminal conviction by itself may make the imposition of a significant bar from the industry a reasonable and warranted sanction. When the Division must rely on cases arising from criminal convictions to argue that Mr. Gonnella's conduct was egregious and featured a high degree of scienter, *e.g., Scammell, supra*, it is as clear a sign as any that such sanctions (permanent bar) are not warranted.

To make matters worse, the Division relies on many of the same cases arising from criminal convictions [*e.g., Zollino, supra*; *Mandell, supra*; Div. Br. at 15] to argue that Mr. Gonnella's perceived failure to acknowledge the wrongfulness of his conduct merits an industry bar of greater duration. But it is quite different when someone has been found guilty of criminal conduct beyond a reasonable doubt, either by guilty plea or jury verdict, and continues to deny or acknowledge any wrongdoing. The Division faults Mr. Gonnella for failing to recognize the purported wrongfulness of conduct that, until the Initial Decision, no body or court had ever recognized as a violation of the securities laws, and depends on findings in seeming contradiction with the record, as discussed elsewhere in Mr. Gonnella's cross-petition and accompanying brief.

Failure to recognize the wrongfulness of conduct that is plainly wrongful is thus different from challenging the Division on the viability of a theory of liability that had never been seen as actionable as fraud until the ALJ's decision below, and involving conduct that was ambiguous enough to warrant clarification at Barclays' annual training in 2011 (after the trades at issue) so as to better define the scope of and compliance with its aged inventory policy. T 1238-40. Because this case involves conduct that is *not* flagrantly or blatantly fraudulent, a perceived failure to acknowledge wrongdoing is less significant as a factor bearing on the appropriate penalty than in cases where there can be no reasonable disagreement that the underlying conduct was fraudulent, or where the conduct fits neatly into an established category of proscribed behavior. *See e.g.*, *Scammell, supra* (insider trading); *Lawton, supra*, at 2-5 (dissemination of false account statements and overvaluation of firm's assets to induce new investments); *Clifton, supra*, at 3-8 (material misstatements and omissions and concealment during and after conference call with investors about partnership interests in oil and gas concern); *Zollino, supra* (Ponzi-type scheme featuring false representations to investors); *Mandell, supra*, at 4-5 (manipulation of stock offering by inflating price on basis of misrepresentations and fraud in offering).

Moreover, insofar as this appeal does not fall within the scope of the Commission's mandatory review of an initial decision by the hearing officer, but was discretionary, *see* Rule of Practice 411(b), the Commission's grant of Mr. Gonnella's cross-petition for review signals at the very least that the initial determination of actionable wrongdoing ought to be reconsidered. And since the initial decision "ceased to have any effect" once Mr. Gonnella filed his cross-petition for review, *see Johnny Clifton*, Exchange Act. Rel. No. 7039, at 2 (Oct. 9, 2013), Judge Grimes' decision, the lone case where violation of an internal aged inventory policy was viewed as an actionable violation of the antifraud statutes, has no legal force. Thus, unless and until the Commission sustains Judge Grimes' findings as to liability, Mr. Gonnella's perceived failure to acknowledge wrongdoing should be accorded very little probative weight in the determination of an appropriate penalty. In any event, Mr. Gonnella acknowledged wrongdoing in using his cell phone to conduct business with King and Gleacher. T 861. Thus, the Division's insinuation that Mr. Gonnella has obstinately refused to admit any wrongdoing [Div. Br. at 15] is false.

Increasing the penalty beyond one-year requires a finding that the conduct involved was truly egregious, as the Division appears to recognize. But try as it might, the Division will find no case or decision with a sanction anywhere near as severe as it seeks for conduct so relatively trifling. A view of the conduct as egregious depends on the fiction that Mr. Gonnella was somehow motivated by his own self-interest and that he was trading with Mr. King "for his own benefit." Div. Br. at 13. Even if that were true – for instance, if there was a real link between the aged inventory charges and Mr. Gonnella's compensation or bonus – the conduct at issue still would not be sufficiently serious to warrant the descriptor "egregious," much less egregious enough to warrant a lifetime bar from the securities industry. Thus, Mr. Gonnella's conduct is either not egregious or far less egregious than the type of fraud that has been an actionable basis for a permanent industry bar.

In *Mayer A. Amsel*, Exchange Act Rel. No. 37092 (Apr. 10, 1996) [Div. Br. at 13-14], for example, the Commission upheld a penalty imposed by the NASD that barred the respondent in all capacities. That case, however, featured paradigmatic parking in which the respondent used fictitious accounts, fictitious persons, false invoices and other forms to generate fictitious trades in order to conceal the firm's net capital position, and to the material detriment of his firm and its customers. *See id.* at 3-6. It was a systematic scheme, a wholesale perversion of the trader's function. Perhaps most significantly, there was a clear link between the false trading and the respondent's compensation; he was entitled to 50% of the profits from the firm's trading account such that the parking scheme benefitted him directly, not the firm. *See id.* at 3, 10. And that case was not an appeal by the Division asking for a more severe sanction; the respondent himself appealed the propriety of the ban. *Id.* at 10.

Similarly, no fair-minded person would equate the conduct in *James C. Dawson,* Investment Advisors Act Rel. No. 3057, at 2-3 (July 23, 2010), wherein the investment advisor cherry-picked profitable trades and allocated them to his personal account to the direct detriment of his clients, as on par with Mr. Gonnella's. The Division's repeated reliance on cases featuring truly egregious conduct tells more about the weakness of its position and the lack of need for a permanent bar than it counsels in favor of a fair view of Mr. Gonnella's conduct. Rather than being described as egregious, a more apt descriptor would be an awkwardly-conceived attempt at implementing his employer's policy while preserving the opportunity to purchase securities that Mr. Gonnella liked and that, but for the aged inventory policy, he may not have sold in the first instance.

In the same vein, the Division grossly overstates the level of *scienter* involved and minimizes just how equivocal and weak was the evidence of Mr. Gonnella's willfulness. As discussed elsewhere, Mr. Gonnella telegraphed in his messages to King (and to others to whom he initially offered the bonds at issue) that he intended to repurchase the bonds after the calendar month-end turned, and that he was motivated to sell by Barclays' aged inventory policy. T 487, 749-66. Given Mr. Gonnella's belief (uncontradicted by the Division below) that his bonus and compensation would not be affected in any material way by aged inventory charges, as well as the disparity between his trading profits (over $17 million for the year to date) and the aged inventory charges avoided (approximately $725,000), and the significant aged inventory charges he incurred on other securities he held in his trading book (over $1 million in 2011), it is difficult to conclude that he was acting with *any* scienter, let alone the "high degree" the Division attributes to him (at 15, 18) in conclusory fashion. T 474-78, 517, 787-96.

Even so, it might be possible to attribute *some scienter* if the aged inventory policy were clear and unambiguous, but Barclays' need to clarify it subsequent to the trading activity, and that it was only escalated up the chain of command after that clarification, ultimately precludes that finding. Any inference of *scienter* is further undercut because after that compliance meeting, Mr. Gonnella approached his compliance officer, reminded him about the trades at issue, and asked him if he would speak to Mr. Gonnella's supervisor about them. Tr. at 1241, 1261-62. Mr. Gonnella's unease that his conduct may have violated his employer's internal policy is not akin to knowledge that his course of conduct violated the securities laws or that intended to commit fraud.

The Division goes further astray (at page 14) in attempting to buttress its argument by resort to the penalty that King assented to, a three-year bar. For one, King did not especially like working in the securities industry, was no longer employed in it, and most significantly, *had no intention of returning to it.* T 201, 425-26, 450, 818-19. Thus, Mr. King's bar and its duration was purely symbolic, and the Division's reliance on it has all the false piety of a vegetarian professing his devotion by giving up steak for Lent. Mr. Gonnella's one-year suspension (and accompanying civil penalty of $82,500, as opposed to King's $0) is a far more substantial penalty because of its effect in the real world and on Mr. Gonnella's ability to earn his livelihood, rather than in the abstract. Second, King's penalty is more a product of the Division's successful exploitation of its position of power over King than a reasoned assessment of what the appropriate penalty should be for someone in King's position. The three-year ban was a contrivance of the Division's; it was not the product of a reasoned assessment by an independent hearing officer or the Commission itself, both of which may well have concluded that a shorter period of suspension was in order, if any. Third, King's penalty is irrelevant and has no bearing on the propriety of Mr. Gonnella's; King may have simply agreed to a bad deal. Fourth, given the marked disparity between King's testimony at his pre-hearing deposition and at the hearing itself (discussed at pages 15-16 of Mr. Gonnella's brief in support of his cross-petition for review), the likelihood that he perjured himself at one or both of those proceedings is a strong counterweight to any disparity in their respective levels of culpability.

It is not in doubt that cooperating witnesses are often less culpable than those they testify against and are often deserving of lesser sanctions, but the Division elevates (at page 14) that principle to a hard and fast rule of law that cooperating defendants "should not receive a more severe sanction than the ringleader who continues to deny wrongdoing," a purported rule from which no derogation is possible. Judge Murray's decision in *Robert Sayegh*, which the Division cites, of course says no such thing, but merely observes that settling respondents "may properly receive lesser sanctions than they otherwise might have received based on pragmatic considerations," a principle with which Mr. Gonnella has no quarrel.[1] SEC Rel. 118, at 10 n.12. And as discussed in Mr. Gonnella's opening brief and above, he has legitimate reason to deny wrongdoing, unlike the executive in *Sayegh*, at 3-5, whose conduct in manipulating the stock price of a security in which the brokerage was a major holder was plainly a violation of the anti-fraud statutes, and the illegality of which was not seriously in question. Any perceived disparity in respective penalties of Messrs. Gonnella and King is more a function of the Division's

[1] In any event, *Sayegh*, *supra* at 7, did not result in an industry-wide bar, in part because the respondents, like Mr. Gonnella, "were not found guilty of criminal conduct, do not have records of prior securities law violations, did not substantially enrich themselves by their activities, and did not threaten judicial and regulatory officials who dealt with them." These factors (as well as others) counsel a far more lenient sanction than the permanent bar that the Division urges.

overreach and its myopic view of this case than it is reflective of a need to correct the disparity by arbitrarily increasing the severity of Mr. Gonnella's industry bar.

The Division also failed to explain how the public interest requires, let alone even suggests further sanction, insofar as the purported victim of Mr. Gonnella's conduct was his employer and not the investing public. While defrauding an employer or breach of a fiduciary duty may, under certain circumstances constitute as much a violation of the securities laws as defrauding members of the investing public, and may, under certain circumstances be as egregious as defrauding the investing public, it was plainly not so egregious here. The Division's professed vindication of the public interest fails to reconcile how eagerly Mr. Gonnella was welcomed back into the securities industry by an employer who was on notice of the relevant conduct and who is hardly a neophyte. T 1276-80; 1318-19. KGS-Alpha, a sophisticated market player, hired Mr. Gonnella with the knowledge of what occurred at Barclays, and on the enthusiastic recommendation of those who only reluctantly terminated him at the behest of Barclays' legal personnel (which was more in the nature of protecting itself from regulatory scrutiny than from any threat posed by Mr. Gonnella). *See id.*; *see also* T 859, 869, 1112. The Division's view of what the public interest requires is thus overly paternalistic to the point of stifling productive trading activity, and it should not step into KGS-Alpha's shoes and suggest that it needs protection from a menace that KGS-Alpha does not appear to recognize. The Division seeks to couch its preferred sanction under the guise of a deterrent effect, but the reality is that it would have much more of a chilling effect on legitimate market forces.

The Division's brief also reflects a disturbing view that a lifetime bar is increasingly seen as a routine and default sanction in enforcement actions, and that it should be the petitioner's burden to show why a lifetime ban is unnecessary. In reality, it is an extraordinary sanction for conduct that, when all the adjectives are scrubbed away, is a largely ordinary and mundane workplace peccadillo. That the trades – which in spite of the Division's efforts to suggest otherwise – totaled twelve over six-months does not mean that the conduct was not limited in scope, as Judge Grimes found. The Division conflates (at pages 16-17) recurrence with scope, but they are not one and the same. A permanent bar here is a nuclear option in response to throwing a few small rocks. It is doubtful that any one of us – the Division's attorneys included – would accept a one-year suspension as either a slap on the wrist or an otherwise lenient penalty. Further, imposition of a lifetime ban would undercut the Commission's ability to differentiate far more serious and blameworthy conduct, as reflected in virtually every case the Division has cited.

Further, the Division's argument that the twelve month suspension imposed by Judge Grimes would insufficiently deter future misconduct by Mr. Gonnella is risible. Mr. Gonnella has already suffered the loss of an extremely lucrative position as a trader at Barclays, the loss of millions of dollars in compensation and the inability to work in the securities industry since these proceedings were instituted in February 2014. The finding of liability in this case and the imposition of a 12-month suspension in addition to these other devastating consequences are more than sufficient to deter Mr. Gonnella from engaging in similar conduct in the future.

In the final analysis, the Division appears to view the one-year industry bar as an insufficient payoff for its efforts in pursuing this matter. The determination of an appropriate penalty is not reached by reference to the amount of work the Division performed such that it can view its dogged persistence as worthwhile. A permanent bar would only be justified by a view of the egregiousness of the conduct and of Mr. Gonnella that is at odds with the record. If the Division legitimately holds such a view, it is more a function of its wrong-headed view of the case rather than how the facts appear when not under the glare of the Division's microscope. For all of these reasons, Mr. Gonnella respectfully urges the Commission to reject the Division's cynicism and its petition for review, and determine, as did Judge Grimes, that a one-year industry ban is an appropriate sanction that reflects the desired balance between fairness and deterrence, and is eminently in the public interest.

Respectfully submitted,

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