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SECURITIES AND EXCHANGE COMMISSION

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In the Matter of the Application of ANTHONY A. GREY 1500 Lake Knowles Circle Winter Park, FL 32789 c/o Peter J. Aldrich, P.A. 100 Village Square Crossing, Suite 201 Palm Beach Gardens, FL 33410 For Review of Disciplinary Action Taken by FINRA	FINRA Disciplinary Proceeding No. 2009016034101 3-16230

Appeal of National Adjudicatory Council Decision dated October 3, 2014
and the prior FINRA Office of Hearing Officers decision dated June 20, 2013

INITIAL BRIEF OF APPELLANT

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TABLE OF CONTENTS

TABLE OF CITATIONS

CASE LAW

OTHER AUTHORITY

INTRODUCTION AND BACKGROUND

Appellant Grey appeals the October 3, 2014 Decision of the National Adjudicatory Council (the "NAC Decision"), which affirmed an earlier ruling of a hearing panel (the "HP Decision"). Grey respectfully submits that all of the contentions he has consistently made from the beginning of the regulatory proceedings against him have merit and apply to the NAC Decision. These arguments are contained in the record in multiple places, including in the transcripts of the evidentiary hearing, and most compactly in the two briefs Grey filed in the NAC appeal. (R.1921 and R.2021). We realize the record will be carefully scrutinized by the SEC in this appeal, and therefore these arguments will be re-stated here in somewhat abbreviated form. We will also address certain aspects of the NAC Decision which modify the HP Decision in regard to the sanctions imposed.

Considering that Grey was never the subject of a regulatory enforcement action before this case, it is implicit in the Decisions that Grey suddenly deviated from previous behavior patterns in order to commit fraud, in order to make profits which were insignificant. Both Decisions misunderstand the significance of this by rebutting an argument Grey has not made – that a prior clear history requires that Grey's conduct here should be excused or considered to be mitigated – when his true arguments are different: first, where the existence of scienter must be determined, its likelihood is a function of contextual factors such as the Respondent's profit motive and "modus operandi" as expressed in any previous regulatory incidents; and second, where a penalty is to be assessed, substantive due process requires that it be proportional to the wrong, and not excessive.

With that in mind, this is a case where the Respondent had no motive to commit the alleged fraud, since the spoils of such wrongdoing were insignificant, and he suffered a penalty entirely disproportionate to the wrong, bringing about a forfeiture of his previously unmarked 30-year career.

FINRA does not dispute that 2008 - 2009, the material period in this case, was a time of unprecedented chaos in the financial markets. It is exceedingly important to note that the trades which the Decisions found to be fraudulent, all occurred within a few weeks in late-2008, the most tumultuous segment of the financial crisis, and consist of basically *6 trades in 6 bonds*. (R.628).

FINRA's expert testified that markups on the disputed transactions ranged from 5.36% to 19.12%, and the Panel accepted these supposed markups as fact. (R.1842). Based on these erroneous figures, the Panel issued a Decision, which the NAC confirmed, in which Grey was found to have committed fraud through excessive markups and the so-called "interpositioning" of his own account within the order flow in this handful of trades. Career-ending sanctions were imposed.

The overarching premise of the Decision is that Grey acted in an inexplicably illogical fashion by defrauding 4 clients out of a minuscule amount of money on 6 trades, while charging these same and many other clients fair prices on thousands of other transactions during the identical time period. *Indeed, unchallenged trades occurred in the same customers' accounts on the same days as the disputed trades.* We submit that it is radical, nonsensical, and illogical to view the evidence as proof that Grey committed fraud on a handful of trades while not doing so on many other contemporaneous trades with the same customers.

THE DISPUTED TRADES

The first disputed sale to customer Godley was on November 11, 2008 (Collier at 19.12% markup) and the second on December 22 (Florida State at 16.88% markup). But on November 11, Grey also sold Godley 10 Fernandina Beach at a markup of 6.68%. (R.1819). No charges were brought on this sale.

Similarly, on December 22, the same day as the "fraudulent" Florida State sale, Grey sold the customer Florida Ports and Miami Dade bonds at presumptive "markups" of 13.39% and 15.18%. (R.1817). No charges were brought on these.

This is representative of a pattern of inexplicable inconsistencies and paradoxes. If Grey was coldly calculating his fraudulent scheme, it is illogical that he would defraud Godley on one trade on the same day he sold Godley multiple different bonds in which he did not defraud him. The same applies to the December 22 trades. It is inexplicable why Grey confined himself to fraud on just two out of a possible contemporaneous five trades.

These paradoxes are found throughout Enforcement's case. *In every single instance where Grey supposedly overcharged the customer, he simultaneously sold the customers other bonds in transactions which have not been challenged.* For most of these parallel transactions, Enforcement calculated the markups to be as high as for the disputed trades.

On December 22 Grey supposedly defrauded Demetree on Highlands Health by charging a markup of 8.62%. Yet on that same day, Grey sold Demetree Cape Coral and Marion at markups of 11.09% and 4.99%, and two weeks later, Grey sold Demetree Richmond at a 5.95% markup. In the ensuing months Grey sold the customer Cityplace twice, at 2.64% and 4.64%; Gulf Breeze at 5.45%; Highlands Health (the same bond that Grey "defrauded" Demetree on in December) at 6.43%; Hernando at 1.75%; and Leesburg at 5.01%. In other words, according to the Decisions, Grey cheated Demetree on only one trade out of ten, leaving as unchallenged, markups of 11.09%, 4.99%, 5.95%, 4.64%, 5.45%, and 5.01%.

The same pattern is repeated regarding customer Sponholzes, supposedly cheated on Osceola (14.38% markup), Ocala (5.36% markup), and Collier (19.12% markup) in October and November.

Yet they too were sold other bonds such as Volusia (8.68% markup), Fernandina Beach (6.68% markup), Hernando (7.09% markup), and Kentucky (3.80% markup). These all had markups exceeding 3%, but Grey was not charged.

The absurdity of the allegations is shown even more clearly in Enforcement's allegation regarding Grey's trading in 2009. *In that **entire year**, Enforcement alleged that Grey made **one** fraudulent trade,* for client Morgan, where the markup was 6.64%, when it should have been 2.5%. This resulted in "excessive" compensation to Grey of $531.27. This alleged fraudulent transaction occurred in July 2009. Yet in January, 2009, February 2009, and in May 2009, Grey sold this same client Orange (7.65% markup), Pasco (4.02% markup), Lauderhill (2.11% markup), Lee (1.67% markup), and Orange School (1.05% markup). Two of these bonds were marked up over 3% but were not challenged by Enforcement. It is manifestly unbelievable that Grey would cheat a regular customer on *one* transaction to make a trivial "extra" $531, while simultaneously dealing fairly with the client on many other trades at the same time. Viewing it more broadly, it is positively absurd to believe Grey intentionally cheated one client out of $531 on one trade in an entire year, while doing thousands of unchallenged trades with other clients, and earning a seven-figure income. Yet this absurdity was affirmed in the NAC Decision.

During the material period, Grey placed thousands of trades and his income was well over $1.5 million. Yet FINRA selected only a handful of trades with insignificant compensation to charge him, ignoring reams of other trades to the same clients with equally "high" markups. Both the HP Decision and NAC Decision gloss over this glaring contradiction, when it should be seen as proof of fundamental flaws in FINRA's case.

Enforcement's expert McKinney said that the markup was the difference between what Grey paid for the bond and the sale price to the customer. Since there was little other contemporaneous trading in the disputed subject bonds, these "markups" could be made to appear excessive. This would not work with the thousands of other trades, including those where the same calculation showed equally high markups, because contemporaneous data would justify Grey's position that the markups were not really as high as FINRA calculated. Thus, it is Enforcement's flawed markup calculations on outliers with no contemporaneous trades which forms the proof of its case.

HOW TO CALCULATE MARKUP

The markup on a bond is determined by identifying the prevailing market value for the bond at the time of the disputed retail sale, and comparing this value to the price paid by the customer. The difference in each case is the markup on that bond:

> A dealer that is acting in a principal capacity in a municipal securities transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price.

MSRB Notice 2010-10 (April 21, 2010). *Department of Enforcement v. Lerner,* 2009 FINRA Discip. LEXIS 5 (July 30, 2009). Therefore, stated simply in the context of this case, if each customer paid approximately 3% or less over the prevailing market value, then it necessarily follows that the markups were appropriate and lawful. It also follows that the so-called "interpositioning" was inconsequential.

<u>Determining The Prevailing Market Price</u>

Ordinarily, the prevailing market price to the customer is deemed to equal the price paid by the seller (Grey) when the seller acquired the bond. *Lerner.* However, this "cost-basis" assumption can be altered if other data indicates a different value. *Id.* Whether such a deviation from the cost basis was proper here is the fundamental disagreement in this case, as indicated by McKinney:

> Q All right. And the disagreement in this case, the entire disagreement, and the entire reason and the only reason we are here is because Tony Grey says the prevailing market price of the bond was what the customer paid, and you say no, it's what he paid when he bought it?
>
> A Because clearly the rule we go by is in absence of definitive market trades, we have to go back with the contemporaneous price he bought it at. So like it or not, that's the way the rule works.
>
> Q The rule doesn't say that. The rule says in the absence of any other data, any other reliable indications, right?
>
> A Right.
>
> (R.888-889).

Thus, Enforcement claimed the cost basis was the prevailing market price while Grey said there were other factors which required that the price be set differently. The Panel accepted McKinney's calculations. The effect of this was to effectively neutralize the preeminent rule on pricing, MSRB Rule G-30, which requires "fair and reasonable prices", as well as to ignore the law which makes yield the preeminent pricing metric.

<u>McKinney's Testimony Was Based on a Flawed "Best Execution" Standard</u>

MSRB Rule G-30 is crystal clear that "fair and reasonable" prices must be set by a dealer. Indeed, on August 6, 2013, the MSRB issued a "Request for comment on whether to require dealers to adopt a 'best execution' standard for municipal securities transactions." The MSRB stated, "However, MSRB rules, unlike rules that apply to the equities and corporate fixed income markets, do not impose a "best execution" standard."

But McKinney applied the "best execution" standard, testifying over and over that Grey was obligated to give his customers the "best execution" price. (R.891):

> "He owes that client best execution." (R.852).

> "...the pressure for best execution is a real mandate right now in this industry..." (R.853-854).
>
> "...it's (the disputed trades) not the best execution." (R.855).
>
> "You deserve to get the best execution you can in the market." (R.863).
>
> "...those that got to come in in the market deserved a great execution, the best execution." (R.875-876).
>
> "...[N]ow he is a broker protecting his client to give him the best execution he can." (R.888).
>
> "...people in the market deserved to get the best execution..." (R.905).
>
> "His customer...deserves to get best execution." (R.921).
>
> "...I have an obligation to give them best execution. I see no evidence – I've said this ten times – of him giving best execution." (R.924).
>
> "...we have to prove every day that we are getting the best execution..." (R.936).

This improper standard was relied upon in the DOE closing: "So these customers didn't get best execution, they didn't get Mr. Grey's prices, they got what he decided they should get and that was all." (R.1079).

This is dead wrong, as the best execution standard is not applicable here. Grey's expert, John Bagley, who has worked as a bond trader, stated "So the standard for municipals was always based upon a fair and reasonable price because you rarely had any kind of depth in the market." (R.960).

This distinction is absolutely crucial. Since McKinney believed a best execution standard should be applied, his entire approach to determining prevailing market value was necessarily based on this standard. He assumed that if Grey could get an execution at "$X", then the customer should get that same execution – the "best execution" – at "$X" plus 3%, with perhaps an insignificant market movement adjustment. This implies that Grey's price should be taken as the prevailing market value. In making this mistake, McKinney entirely ignored MSRB Rule G-30, as well as what the cases say is the preeminent metric – yield.

McKinney did not price a single one of the subject bonds on the date of sale to the customers, or on the dates Grey bought them. Instead, he just *assumed* that the market price on both dates was what Grey paid for them. He supported his flawed assumption with a circular and obviously erroneous reasoning process. Instead of actually pricing the bonds on the key dates, McKinney attempted to justify his use of Grey's cost basis as market value by characterizing Grey's cost as "agreed" upon between two brokers in the marketplace. He stated, "Gardnyr Michael and Knight Bond had agreed on this price by doing their own homework and traded at 76.88." (R.831). Incredibly, this preposterous and transparently misleading testimony was accepted by the Panel and the NAC.

Gardnyr Michael was not an independent entity which "agreed" on a prevailing market price in the bid-wanted auctions where the bonds were purchased. Gardnyr was, in effect, Grey himself. It was Grey who purchased the bonds from Knight and the other sellers. Grey's "homework" caused him to place bids for these bonds 10 points below what he believed the market price to be. (R.750). This testimony was undisputed. McKinney did absolutely nothing to determine if Grey's prices represented market value, as he never spoke with either Grey or the sellers. In particular, McKinney admitted that he had no idea what "homework" the sellers did:

> Q But Edward Jones could have determined that 71 and a quarter was a price that it was unwilling to accept and turned down the bid, right?

A I don't know. I don't know what Edward Jones, how they operate.
(R.688).

Thus, McKinney's cost basis assumption was founded on an absurd notion that the "market" set the price for the subject bonds, when in fact, it was Grey bidding below the market.

Effect of Financial Crisis

The subject transactions took place in the midst of the financial crisis when price discovery was very difficult. Historically, municipals trade at a yield which is less, or at a discount, to U.S. Treasuries. During the material period, this historic relationship was reversed. For this and other reasons related to the unprecedented turmoil in the markets, large spreads in municipals were commonplace, and there was huge unpredictability. This is why Grey was able to buy the bonds below their market value. These conditions were not present in *Department of Enforcement v. Lerner,* 2009 FINRA Discip. LEXIS 5 (July 30, 2009) or in any case in recent memory. Therefore, the instant case is completely different from *Lerner,* and the failure to recognize this is unrealistic and unfair.

Bid-Wanted Auctions

In *Lerner* and the other cases relied upon by Enforcement, the bonds were not acquired in bid-wanted auctions. The significance of this point in undermining McKinney's methodology cannot be overstated, though it was ignored in the NAC Decision. The very nature of the bid-wanted process precludes conclusive reliance on the auction pricing as equaling market value. As Grey explained in unrebutted testimony, he placed bids 10 points below the market in each auction, bidding around bid 100 bonds per day to buy 5. Grey was able to purchase the bonds for his own account at what seemingly were extraordinarily low prices. Thus it is absurd to conclude that bid-wanted sales represent "fair market value".

This is why the markup is calculated from the prevailing market price at the time of sale to the retail customer, not from the cost basis of the dealer. Of course, most often the cost basis and the prevailing market price at the time of the retail sale are presumed to be the same because the municipals market is generally stable. But the market conditions at the time of the sales in dispute here were unprecedented in history and rule out such a methodology. Grey's testimony that he bid below market price in bid-wanted auctions was never challenged. Indeed, McKinney impliedly confirmed it in his testimony about odd-lot pricing.

Grey Purchased the Bonds in Odd Lots at "Crucifixion" Prices

Bonds sold in lots less than 100 bonds are "odd-lots". (R.868). As McKinney testified: "nobody buys five bonds, and I agree, it's really a tough thing to sell five or ten bonds because when a customer ever has to sell them, he gets crucified in the market." (R.863). "And because they were odd lots, they are going to trade at even higher yields." (R.854).

Grey bought all of the subject bonds in odd lots. Therefore, according to McKinney, the prices Grey paid amounted to a "crucifixion" of the sellers, meaning they received less than the prevailing market value. This proves that Grey bought them at prices under market value, just as he testified. McKinney's opinion that odd-lot sellers get "crucified" does not square with his contention that Grey paid market value. The NAC Decision does not counter this crucial point.

Here, it is instructive to recall the many other alleged high markup trades where Grey was not charged. This was because other contemporaneous trades verified that Grey did not mark these up excessively, even though his cost basis was many points below the price to the customer. Enforcement did not calculate the markups correctly, else Grey would have been charged on these.

Since there were no other trades in the disputed bonds, McKinney could get away with alleging high markups on the handful of trades in dispute here.

In sum, the purchase of the disputed bonds during the financial crisis in bid-wanted auctions, and in odd-lots, presents a challenge for determining market value which cost-basis valuation does not answer. A more reliable metric than cost basis is needed as a foundation for determining the prevailing market value.

Yield is the Key Metric in Assessing Prevailing Market Value

The cases teach that the most reliable way to assess the market value of a bond in a markup case is to compare it to the yield curve. *Grandon v. Merrill Lynch*, 147 F.3d 184, 1998 WL 321695 at 5 (2d. Cir. 1998). Thus, the Second Circuit has opined:

> Among this welter of considerations, the MSRB has stated that the resulting yield to the customer is the "most important" factor in determining whether the price (including the markup) of a municipal security is fair and reasonable.

Grandon v. Merrill Lynch.

Likewise, in the *Lerner* case, the panel held, "The MSRB has advised that in determining whether a municipal bond has been fairly and reasonably priced, the "most important" factor to be considered is "the resulting yield to a customer". *Lerner,* at page 38. Yet McKinney had no yield data showing the yields were too low for Grey's customers. Thus, Grey's data was undisputed and shows yields in every instance above the yield curve.

Stated simply, if the yield to the customer exceeded the municipal yield curve on that date, then the customer must have paid market price or less for the disputed securities. Further, if the customer paid no more than the prevailing market price plus a markup of around 3%, there can have been no violation.

Therefore, any reliable determination in this case of the prevailing market value of the subject bonds must be based on and compared to the yield curve. Analyzing yield at the point of sale eliminates the problem of the tumultuous 2008-2009 market, when yields changed very rapidly. The yield curve takes into account where the market actually was at the point of sale to the customers. It also eliminates the bid-wanted auction problem and the odd-lot "crucifixion" discount. The MMD records, which give market yield at the point of sale, were placed in evidence.

Note that even McKinney conceded the importance of MMD data: "Everyone uses this as a guide to see what the flow of the market is." (R.837). McKinney's use of the MMD data precludes criticism of Grey's use of that same data on the actual trade dates. Grey did exactly what he supposed to do: seeing there was no contemporaneous trade data, he looked at the yield curve to validate his prices to the customers. *In every case, the customers' yield exceeded the MMD yield.*

McKinney used the MMD data in a misleading way to neutralize its confirming effect on Grey's pricing. He used Grey's acquisition cost as a starting point, without ever actually doing an assessment of the fair market value at that time. This is the problem discussed above. But McKinney compounded his wrong by misusing the MMD data. He "adjusted" the acquisition cost basis by market performance as measured by the MMD scale. This created trivial "price" differences between the dates of acquisition and sale and was done only to appear to "use" the MMD data. McKinney then calculated a 2.5% or 3% markup, depending on the bond, and added that markup to his MMD-adjusted cost basis of each bond on the date of each retail sale in dispute. He then compared the total to the price charged by Grey to the customers. The difference between what Grey charged and what McKinney calculated is identified as the alleged excessive markup. (R.1223-1224).

It is easy to see that it makes no sense at all to use the MMD as a "compass" to establish the direction of the market, but then reject that same data as a tool to measure value. The proper use of the MMD data was as a comparison metric to see if the customers were obtaining yields in excess of the yield curve. When done, this proves the markups were within allowable limits.

YIELD ANALYSIS

The evidence showed that in every instance, the yields obtained by the customers exceeded the yields shown on the municipal yield curves for similar bonds (and far above treasury yields):

Collier County:	MMD yield curve:	5.71%
	actual yield to customer:	6.10%
Osceola bond:	MMD yield curve:	5.80%
	actual yield to customer:	6.32%
Florida State:	MMD yield curve:	6.38%
	actual yield to customer:	7.50%
Highlands School:	MMD yield curve:	4.22%
	actual yield to customer:	5.16%
Ocala:	MMD yield curve:	5.84%
	actual yield to customer:	6.00%
Highlands Health:	MMD yield curve:	6.38%
	actual yield to customer:	7.25%

If McKinney's supposed reasonable markups were used, the yields on these trades would be astronomically higher than those above, which already far exceeded the yield curve. For example, if Florida State, which was sold to Godley at a 7.50% yield, had been sold instead at McKinney's maximum price, the yield would have been in the 8.5% - 9% range. (R.766). Not one iota of evidence was offered by Enforcement to support the notion that such tax-free yields represented any kind of marketplace reality.

Grey Sold at Prevailing Market Price and Backed Out His Markup

If the legal precedent is accepted then yield is the key indicator of pricing, and it becomes indisputable that these customers were charged *less* than market price for the securities before the markups. This was as a consequence of how Grey determined the selling price of the bonds to the clients: he priced the bonds at the prevailing market price, and then backed out his markup, instead of adding his markup on top of the price.

Bagley's Multi-Faceted Analysis Showed Yield Metric Was Accurate

In effect, McKinney did absolutely nothing except to presume that the cost basis was the prevailing market price, and make virtually meaningless adjustments based on the yield curve. McKinney made no effort at all to compare these bonds:

> [S]o there is no real data and there was no trades in the market on those CUSIP members, so there was no other trade review or trades that we could use to try to compare them. So there really wasn't a good comparison."
> (R.829).

According to the NAC Decision, Grey's expert, John Bagley, used a supposedly "flawed" methodology. Yet, careful analysis shows that he took a much more conscientious and practical approach than FINRA's expert. Bagley, formerly in charge of USB's municipal trading desk, and later its entire trading desk and trading in the secondary market, is a vastly more sophisticated and experienced expert. Testimony at R.970-980 details his analysis, and includes comparables as to 3 of the bonds. Following is a summary:

Trade No. 1
Collier County Fl HSG 5.40% 12/01/27 CUSIP 19464HBV
All previous trades in CUSIP between $97 - $105
Grey's client paid $92.174
"A" rated MMD scale 5.71% vs. 6.10% for client (+ 39 bps)
Bloomberg evaluation $100.102 (would be significantly higher but for 30 day rolling call)

Trade No. 2

Fl State Muni LN Council Rv N Miami Bch Water 5.40% 08/01/32 CUSIP 342815KE5

All previous Customer buy trades in CUSIP between $77 - $102.766

Grey's client paid $72.525 (cheapest customer buy ever)

"A" rated MMD scale 6.38% vs. 7.50% for client (+ 112 bps)

Bloomberg evaluation $101.00

Entire maturity called 01/22/13

Trade No. 3

Highlands Cty FL Sch Brd COP 4.00% 03/01/19 CUSIP 342815KE5

All previous Customer buys in CUSIP between $99.709 - $100.00

Grey's client paid $91.25 (2nd cheapest customer buy)

"A" rated MMD scale 4.22% vs. 5.16% for client (+ 94 bps)

Comp trade - "A" Pasco Cty FL Sch Brd COP 4.375% 08/01/19 CUSIP 702528EC0

On 06/22, Customer bought at 5.07% yield vs. 5.16% yield for Grey's client

Bloomberg evaluation $109.09

Trade No. 4

Osceola Cty FL IDA PM Wells Charter Sch 5.00% 08/01/31 CUSIP 687906BA4

All previous Customer buy trades in CUSIP between $99.00 - $104.336

Grey's client paid $84.17

"A" rated MMD scale 5.80% vs. 6.32% for client (+ 52 bps)

Comp trade - "A" Osceola Cty Sch Brd COP 4.50% 06/01/28 CUSIP 688028FX2

On 10/23/08, Cust bought at 6.06% yield vs. 6.32% yield for Grey's client

On 11/03/08, Cust bought at 6.16% yield vs. 6.32% yield for Grey's client

Bloomberg evaluation $97.155

Trade No. 5

Ocala FL Util Sys Rev 5.00% 10/01/27 CUSIP 674564CZ0

Prior to 10/08, All previous Cust buy trades in CUSIP between $98.373 - $100.00

Grey's client paid $88.77

"A" rated MMD scale 5.84% vs. 6.00% for client (+ 16 bps)

Comp trade - "A" Ocala FL Util Sys Rv 5.25% 10/01/25 CUSIP 674564CY3

On 11/21/2008, Cust bought at 5.73% yield vs. 6.00% yield for Grey's client

On 11/24/2008, Cust bought at 5.53% yield vs. 6.00% yield for Grey's client

Bloomberg evaluation $107.057

Trade No. 6

Highlands Cty FL Hlth Facs Adventist 5.125% 11/15/32 CUSIP 431022PT3

All previous Cust buy trades in CUSIP between $77.465 - $88.917

Grey's client paid $76.03 or 7.25%

12/08 Cust Buy @ 6.97%

12/08 Cust Buy @ 7.00%

12/02 Cust Buy @ 6.50% and 7.00%

"A" rated MMD scale 6.38% vs. 7.25% for client (+ 87 bps)
Bloomberg evaluation $108.395

In short, Bagley studied the bonds in relation to the yield curve, compared the yields, looked at Bloomberg, and used comparables in several instances. Therefore, whether basing the analysis on yield, as required by applicable law, or historical trades in the same or similar bonds discussed above, it is clear that every single client paid a price below the prevailing market value.

With this in mind, even if the methodology was wrong, it certainly stands as powerful evidence that Grey did not act with scienter, as he reasonably believed – based on the universal metric of yield – that his customers were paying a price which was representative of the market.

Panel Ignores MSRB Rule Requiring Fair and Reasonable Pricing

The HP Decision acknowledged that MSRB Rule G-30 requires fair and reasonable prices, and that Bagley testified that the subject customers received fair and reasonable prices. Paradoxically, the Panel then rejected Bagley's opinion as irrelevant by inventing a perplexing distinction between fair and reasonable prices and market value.

We respectfully question how can the price be fair and reasonable if it does not represent the market value? Stated differently, under the Panel's view, fair and reasonable pricing is no safe harbor. Thus, some type of "best execution" standard is what the Panel expected here. No doubt this is an outgrowth of McKinney's repetitive claim that Grey owed the customers "best execution" price. What is very clear from the HP Decision is that compliance with MSRB Rule G-30 can occur simultaneously with a pricing violation, and did in this case.

Almost as an aside, the Panel and the NAC also discounted Bagley's testimony because he supposedly used comparables chosen by Grey. This is just wrong, as Bagley only used comparables on three of the six bonds. Further, his analysis was not based on comparables. Comparables were used as confirmation of his fundamental data which was based on the yield curve and on the trading history of these particular bonds. FINRA's expert made no effort whatsoever to examine other bonds to confirm his opinion. Thus, in an inversion of common wisdom, Bagley has been discounted for doing too much analysis, in favor of the minimal effort by FINRA's expert. It is also noteworthy, if not astonishing, that the NAC criticized Bagley for using round lot bonds as comparables when the bonds in question here were sold in odd lots. This is precisely the point we have made in highlighting McKinney's testimony that the bonds were bought by Grey at "crucifixion" prices. It is impossible that the sale price of those bonds to Grey could be presumptively considered to equate to market price. Yet that is exactly what McKinney did and what the NAC Decision endorsed. This is clear error.

Undisputed Evidence Supports Yield Pricing: Grey Could Have Sold to Street

As further proof of the fairness of the pricing, we presented undisputed evidence that Grey could have sold the bonds for higher prices to the "street". The Panel incorrectly stated: "There was no evidence that Grey had another dealer ready to pay the price at which Grey offered and sold the bonds to his customers..." This is absolutely wrong as Grey testified, without any rebuttal or countering testimony from Enforcement's expert McKinney or any other witness, that he could have sold the bonds to the street at higher prices. This unrebutted testimony is further evidence that Grey sold the bonds to his customers at prevailing market value or less.

INTERPOSITIONING

The Decisions stated that Grey routed the bonds through his personal account solely to enrich himself and to deceive customers. But the undisputed evidence was that the routing was the firm's decision to avoid exposure. (R.681). There was not one particle of evidence that interpositioning was Grey's idea. Therefore, labeling it as Grey's "scheme", as the NAC Decision does, is completely unfair.

Furthermore, Grey's payout at Gardnyr Michael was 70%. This meant that at the small amounts involved here, whether the bonds were being sold from his account or the firm's account made little difference. He stood to profit almost equally either way. Thus, the identical "conflict" would have been in play even if the bonds were sold from the account of the firm without the involvement of Grey's accounts.

This conflict is inherent in all proprietary trading, including by McKinney's firm. Undercutting the finding that Grey's own account created a conflict of interest was McKinney's admission that he does not disclose proprietary sales to his customers. This is the same conflict. (R.937).

McKinney justifies his conflict by arguing that it was not exploited and therefore it is harmless. There is no meaningful financial difference between what Grey did and what McKinney does. In both cases, the customer does not know how much money the firm or advisor is making.

We also note that so-called interpositioning was fully disclosed to the firm and to FINRA through years of audits, that it was transparent, and was subject to supervision and active, real-time oversight.

Finally, it also follows that if we are correct on yield-based pricing, unlawful "interpositioning" could not have occurred, since the passage of the bonds through Grey's personal account did not increase the markup to an unlawful level.

THE FINDING OF 10B-5 VIOLATIONS WAS CLEARLY ERRONEOUS

This finding is predicated on the conclusion that Grey acted with scienter, meaning an intent to defraud. The realistic effect of a finding of disqualification is a lifetime ban from the industry.

The NAC Decision concludes that Grey acted with an intent to defraud, or with extreme recklessness, because he charged excessive markups. In other words, the mere fact of the violation was used as justification for the further conclusion that the violation must have been done with scienter. The NAC Decision offers no rationale for disregarding the common sense observation that it is incongruous to think that Grey would simultaneously cheat the customers on one bond for insignificant compensation, while selling them numerous bonds at the same time at prices which have not been challenged as fraudulent.

Further, the evidence of yield precludes such a finding. It is nonsensical to attribute fraudulent intent to Grey when he was pricing the bonds at better yields that the MMD yield curve, which he believed to be the best indicator of value.

Furthermore, the idea that Grey planned to defraud customers is invalid if one understands the bid-wanted market. The undisputed evidence of how bid-wanted auctions work was is that Grey could not obtain an order from a client in advance. This is because only a tiny percentage of bids, perhaps 4%, are accepted. Therefore, he did not know on any given bond whether he would buy it, or whether he would then re-sell it.

There simply is no good explanation for why Grey would engage in this supposed fraud on such few occasions, for such little money. The compensation to Grey was insignificant and therefore, there was no incentive to mislead.

Another point entirely ignored in the NAC Decision is that there is no discernible consistency to the supposedly high markups. The markups were all different and there was no pattern to the timing of the disputed trades. It appears that these were random events, clearly unplanned due to the nature of the bid-wanted process, and without a defining methodology. We submit that it is far more believable that the markups were a function of Grey's perception of market value than what otherwise can only be seen as random acts of fraud. The patently random nature of the disputed trades is convincing evidence that there was no fraud. Rather, it is indicative of market conditions and his assessments of fair market value based on MMD.

SANCTIONS IMPOSED ARE IMPROPERLY PUNITIVE

Due to the finding on the 10b-5 charge, in effect Grey has been banned from the industry for life. This level of sanction is completely disproportionate to the alleged wrongs, totally out of step with other decisions and settlements of FINRA, and contrary to the purpose of sanctions.

First, the NAC Decision improperly calculates the magnitude of the supposedly fraudulent markups. While noting that a sanction which requires disgorgement of the *unlawful* gains is appropriate, the NAC Decision then sanctions Grey for his entire profit, $15,515. This is the sum of the lawful and excessive compensation. The excessive portion was $9619.90, according to FINRA's exhibit CX-3. (R.1129).

Obviously, we would never take the position that fraud in small increments should be overlooked. But the magnitude of the fraud must surely play a part in the assessment of a remedial penalty. Stated in different terms, we submit that the notion of the proportionality of punishment to wrong is basic substantive due process.

We note that the HP Decision repeatedly uses Grey's "lack of recognition of his wrongdoing" to justify sanctions twice as severe as what Enforcement requested. (R.1861-1862). The Panel viewed Grey's act of contesting the markup calculation as proof that Grey deserved heavier sanctions. This faulty line of reasoning appears to have been carried further in the NAC Decision.

The NAC confuses disagreement over facts with disagreement over compliance with law or regulation. Grey has never disagreed with the idea that markups exceeding 3% are suspect and probably excessive. What he has always disagreed with here is the contention that the markups actually exceeded 3%. This is an issue of fact. The purpose of a trial is to resolve factual disagreements.

Surely it is not a violation of any rule, or an aggravating factor for the respondent to defend himself *on a factual issue.* This is not a case where the facts were undisputed and the respondent refused to admit the significance of those uncontested facts. Rather, in this case the central fact – the amount of the markups – was vigorously contested and was the subject of almost all of the evidence.

Clearly, the NAC and the Panel believed that upon being charged, it was Grey's duty to make a full confession, and that his failure to do so amounts to further wrongdoing. Thus, the Panel has punished Grey not only for the findings of underlying wrongdoing, but also for the act of defending himself *on the factual issue* of whether the markups exceeded *the uncontested* regulatory standard.

There is nothing in FINRA's Sanction Guidelines which justifies sanctions for mounting a defense on a factual issue. The Panel's citation to Principal Consideration 2 (whether the respondent admits the wrong *before detection*) is completely inapposite. This Panel's approach sets an extremely regressive precedent, as it forces respondents to undertake a risk of heightened sanctions merely by defending the factual allegations underlying the charges against them. This elevates every factual allegation brought by Enforcement to a status of presumed correctness, with punishment awaiting a respondent who might disagree. Punishing the respondent for defending himself smacks of a denial of due process and certainly represents a departure from FINRA's own "General Principles Applicable to All Sanctions Determinations", which contains no such principle.

The purpose of sanctions is clear from the General Principles:

> Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.

The punitive and disproportionate nature of the sanctions against Grey can easily be observed by a review of other disciplinary matters. We begin with cases involving settlements of similar charges, focusing on the suspensions. In the matter of *Turnes/StateTrust Investments, Inc.*, FINRA STAR Nos.: 2008013629601 and 2010023001602, there were 563 excessive markups or markdowns, ranging from 8% to 23%. The advisor was suspended for 6 months. In *Shlomo Steven Eplboim*, FINRA Case No. 2008011759202, the advisor was suspended for 10 business days for excessive markups. In *Asa Williams*, FINRA Case No. 2008014271401, the advisor not only sold a CMO with an excessive markup, he also engaged in extensive other misconduct. He was suspended for 20 days. In *Michael Alcide Poutre, II*, FINRA Case No. 2008011759201 the advisor was suspended for 30 days for high markups on corporate bonds.

The level of sanctions observable in the settled cases is also seen in the contested ones. *In the Matter of Investment Planning, Inc., et al*, 1993 SEC LEXIS 1897, 51 S.E.C. 592 (1993), the firm, its president, and three others were charged with excessive markups on corporate and municipal securities in 137 transactions. The firm president, who had been the subject of many previous regulatory actions and had been sanctioned at least four previous times for unfair pricing, was suspended for 90 days. The others received much lower sanctions.

In the Matter of First Honolulu Securities, Inc., Securities Exchange Act Rel. No. 32933 (September 21, 1993), the firm and advisor were charged with excessive markups on corporate and municipal securities in 31 transactions. The advisor was censured and fined. *See* also *Department of Enforcement v. McLaughlin, Piven, Vogel Securities, Inc. and James Cecil McLaughlin*, Disciplinary Proceeding No. C02980073 (censure for four excessive markups).

In *Department of Enforcement v. SFI Investments, Inc. et al*, Disciplinary Proceeding No. C10970176, the firm and the advisors were not only charged with excessive markups in 174 trades, they also falsified order tickets and confirmations, and engaged in interpositioning. The individual respondents were each suspended for 60 days.

In *Department of Enforcement v. Lerner,* 2009 FINRA Discip. LEXIS 5 (July 30, 2009), the case McKinney testified in and which is relied on by Enforcement here, the Panel found excessive markups in over 3,000 trades, resulting in over $1,000,000 in damages to customers. The key individual respondent was suspended for 6 months.

While we do not contend that the results in other cases mandate a certain level of sanctions here, we do contend that at the very least, the other cases should be seen as guideposts. With that in mind, the penalty imposed by the Decisions – a lengthy suspension of Grey, and the finding of a statutory disqualification which amounts to a lifetime ban – makes this case a shocking outlier, without any precedent. It is unimaginable that any fair comparison can be made between Grey's punishment and that of the SFI respondents, who committed 174 violations, created phony tickets and confirmations, and used interpositioning, and who received 60 day suspensions, or with the *Lerner* principal respondent who authorized thousands of illegal markups, costing clients seven figures in damages, and who received only a six month suspension. This is not a just outcome, designed to remediate a wrong involving a small amount of money, but a draconian career forfeiture. Finally, we note that Grey has not been registered since November 2012, over 2 years ago. We have previously contended that this period should "count" in calculating any suspension period.

The NAC Decision, at page 15, states "...we agree with the Hearing Panel's order of suspension against Grey from associating with any member firm in any capacity, but reduce his term of the suspension from two years to 18 months." This modification does little to move this case from its extreme into the proper realm of remedial sanctions.

Indeed, strangely, the "reduction" to 18 months seems to have resulted in a lengthening of the suspension. The original Hearing Panel began Grey's suspension August 19, 2013, stating "If this decision becomes FINRA's final disciplinary action, Grey's suspension shall commence on August 19, 2013, and end at the close of business on August 18, 2015." But according to FINRA's cover letter enclosing the NAC Decision, dated October 3, 2014 and signed by Marcia E. Asquith, FINRA re-calculated Grey's suspension in this way: "The 18 month suspension imposed by the NAC shall begin with the opening of business on Monday, December 1, 2014, and end at the close of business on Tuesday, May 31, 2016." Thus, the "reduction" of the suspension by six months resulted in an extension of the suspension for nearly a year. This appears to be manifestly erroneous.