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16-3433-AG

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

THOMAS C. GONNELLA,

Petitioner,

v.

U.S. SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Review from the U.S. Securities and Exchange Commission

BRIEF FOR PETITIONER

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CASE AND JURISDICTIONAL STATEMENT

Appellant-petitioner Thomas Gonnella seeks a ruling from this Court vacating an Opinion and Order of the Securities and Exchange Commission ("SEC" or "Commission").

On February 4, 2014, the Commission issued a Notice of a Hearing and an Order Instituting Administrative and Cease-and Desist Proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940. (Comm'n Order Instituting Proceedings, February 4, 2014) ("OIP").

The Commission charged Petitioner with participation in stock-parking by engaging in prearranged trades in order to convey a false appearance of compliance with his employer's aged inventory policy and to avoid nonrefundable charges to his trading profits. The Division claimed that Mr. Gonnella, *inter alia*, willfully violated Sections 17(a)(1) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities. (OIP at 7).

In July 2014, new Administrative Law Judge ("ALJ") James E. Grimes[1] held a hearing and issued an Initial Decision on November 13, 2014 ("ALJ Decision"). The ALJ found that Petitioner violated Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that he aided and abetted and caused his employer's violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. The ALJ suspended Petitioner from trading activities for twelve (12) months and imposed a civil monetary penalty in the amount of $82,500. (ALJ Decision at 35).

On December 16, 2014, the parties cross-petitioned for review before the Commission, and after full briefing in 2015 and oral argument on July 22, 2016, the Commission entered an order affirming the ALJ Decision on August 10, 2016. (Comm'n Opinion and Order, August 10, 2016). In its Opinion, the Commission affirmed the findings of the ALJ on the merits and the sanction of the $82,500 civil monetary penalty. (Comm'n Op. at 21-22). The Commission, however, aggravated the trading suspension from twelve (12) months to a lifetime industry ban. (Comm'n Order at 1-2). Commissioner Piwowar dissented from the

[1] This was the ALJ's very first adjudication. ALJ Grimes was hired on June 30, 2014 after serving "13 years at the U.S. Department of Justice as a senior litigation counsel in its civil division and a member of the faculty at the Department of Justice National Advocacy Center." SEC Press Release, No. 2014-129, SEC Announces New Hires, dated June 30, 2014 *available at https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542202073*.

imposition of a lifetime ban based on due process grounds. (Comm'n Op., Dissent at 1).

On September 29, 2016, pursuant to the application of the Petitioner, the Commission issued a partial stay of the civil monetary penalty pending the outcome of this Petition for Review. (Comm'n Stay Order, September 29, 2016). On October 7, 2016, Petitioner, who resides within the Second Circuit, filed a timely Petition for Review under 15 U.S.C. § 78y. (Dkt. 1).

QUESTIONS PRESENTED

1. Whether the Commission committed structural error by designating a presiding ALJ who was not appointed pursuant to the Appointments Clause of Article II of the Constitution?

2. Whether the Commission violated Due Process and otherwise erred as a matter of law by permitting the ALJ to create independent evidence and conduct independent fact-finding after the close of the evidence and without providing Petitioner with notice and an opportunity to be heard?

3. Whether the Commission (a) violated 5 U.S.C. § 553 by creating a cooperation agreement rule in 17 C.F.R. § 202.12, a regulation promulgated outside of public notice and comment, that has a substantial impact on the rights of individuals; and (b) as the prosecutorial agent, violated Due Process

and erred as a matter of law by deferring decision on the penalty for a cooperating witness until after he testified, in contradistinction to the process in Article III courts where independent judges, and not the prosecutors, sentence cooperators after their testimony to ensure reliable fact-finding?

4. Whether the Commission violated Due Process and otherwise erred as a matter of law by imposing sanctions in excess of those ordered by the ALJ and otherwise affirming disproportionate sanctions?

5. Whether the Commission's findings are insufficient as a matter of law to establish substantially that Petitioner *intended* to commit fraud under Securities Act Section 17(a)(1), Exchange Act Section 10(b), and Exchange Act Rule 10(b)-5(a) and (c) where the evidence adduced demonstrated that:

(a) Petitioner believed his conduct was in furtherance of complying with his employer's aged-inventory policy,

(b) Petitioner self-reported a violation after learning about further implications of the policy,

(c) the employer determined that it was neither deceived nor defrauded by Petitioner, and

(d) there was no evidence that the conduct affected Petitioner's compensation or that he believed that it did?

6. Whether the Commission's findings are insufficient as a matter of law to establish substantially that Petitioner *actually* committed fraud where the evidence did not show that the trades at issue could be considered stock-parking because (a) beneficial ownership and risk of loss in fact passed and (b) the limited nature of the trades in this relevant, esoteric illiquid market, distinguishes it from true stock-parking in far more liquid markets?

7. Whether the Commission's findings are insufficient as a matter of law to establish substantially that Petitioner actually aided, abetted, and caused his employer's violations of the books and records provisions of Exchange Act Section 17(a) and Exchange Act Rule 17a-3(a)(2) where there was no fraud?

STANDARD OF REVIEW

The standard of review in this case involving an SEC informal adjudication is set forth in 15 U.S.C. § 78y and 5 U.S.C. § 706(2) of the Administrative Procedure Act ("APA"). Under the APA, a circuit court will set aside the "SEC's actions, findings, or conclusions of law only if they are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Mathis v. SEC*, 671 F.3d 210, 216 (2nd Cir. 2012) (internal citations omitted). A circuit court will affirm the factual findings of the Commission if supported by substantial evidence and "will not disturb the SEC's choice of sanction unless it is

unwarranted in law or without justification in fact." *VanCook v. SEC*, 653 F.3d. 130, 137 (2nd Cir. 2011). *Cablevision Sys. Corp. v. FCC*, 570 F.3d 83, 91 (2nd Cir. 2009) (substantial evidence means "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.").

An appellate court reviews an agency determination on a constitutional issue *de novo*. *Cablevision*, 570 F.3d at 91. A separation of powers error, deemed a "structural error," is not subject to prejudicial error review. *See Plaut v. Spendthrift Farm, Inc.* 514 U.S. 211, 239 (1995). Structural errors require automatic reversal. *Rivera v. Illinois*, 556 U.S. 148, 161 (2009) ("constitutional errors concerning the qualification of a jury or judge" require automatic reversal).

SUMMARY OF ARGUMENT

The Court should set aside the Opinion and Order of the Commission due to structural errors in the composition and conduct of the adjudication. The findings of fact and conclusions of law are clearly erroneous, and its determinations, as a matter of law and policy, cannot be squared with the record and industry practices.

In 2011, Mr. Gonnella was a 26 year-old bond trader at Barclays Bank, dealing in esoteric instruments known as 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 possible bonus. (Division Exhibit 1; T 101-04, 146). Such aged inventory charges, however, had no effect on Mr. Gonnella's base 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, Mr. Gonnella offered them to several counterparties, and then to Ryan King, a trader at Gleacher and Company ("Gleacher"), who bought them. Mr. Gonnella purchased them back a short time later from Mr. King. 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).

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-action, which create an arbitrary atmosphere of uncertainty and fear. Yet, this is the proper forum for challenging several governmental excesses that have violated Mr. Gonnella's constitutional and statutory rights – which if left unchecked, will serve to injure others.

This case is an imperfect storm of firsts – the first adjudication for a new ALJ, the SEC's first deployment of its new cooperation program, and perhaps the first time that the SEC has alleged that the violation of an internal employer-employee policy constitutes fraud under securities laws (even where the employer determined that there was no fraud). Likely a first for this Circuit, Mr. Gonnella asserts an Appointments Clause violation on direct appeal. He also asserts several other pressing due process violations. The new ALJ errantly engaged in a prosecutorial role during the adjudication by engaging in independent fact-finding; the SEC's new cooperation program, which was not subject to public notice and comment, violates long-standing separation of powers principles; and the

Commission prejudiced Mr. Gonnella by increasing the severity of his punishment after he exercised his right to appeal.

Finally, the Commission's myopic reasoning with its findings of fact and conclusions of law contribute to an unduly retributive atmosphere of the day, as well as the perception of arbitrariness, and will inure to the detriment of future traders, employers, and investors if it is permitted to stand. Mr. Gonnella was a young trader who misapplied an employee policy – he is no fraudster and should not forever bear this weight of prosecutorial excess.

STATEMENT OF FACTS

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).

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 had resulted in an increasing number of arbitrary terminations for cause, and that firms sometimes terminated 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. (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 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).

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. This 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 to solicit 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. To the contrary, such trading 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, could possibly have 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, hoping to be rewarded for his "cooperation," either invented or imagined his claim of coded language meant to disguise pre-arranged agreements. 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.

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.

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 humorous 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). 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," and making those overt overtures months before Mr. Miller's vacation, to which the ALJ made so many repeated references. (Division Exhibit 21-22; Gonnella Exhibits SA & SB; T 39,487, 749-52, 754, 756, 759-60, 763-66, 837).

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, directed Mr. King to research the market for other potential buyers, and rebuked Mr. King 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. 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. At the deposition, Mr. King denied being aware of a Gleacher policy that he 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).

For his cooperation, Mr. King agreed to a three-year ban from the industry, a largely symbolic sanction as Mr. King testified that he had no desire to return. (T 201, 425-26). While Mr. King agreed to disgorge $24,000, his agreement with the Division left open the amount of his full fine after the Division had an opportunity to assess the value of his testimony against Mr. Gonnella. (T

394; Gonnella Exhibit 35). Mr. King's fine could have exceeded $125,000. (T 178-79). Following his testimony, the Commission terminated his proceedings and declined to impose any further civil penalty. *See In the Matter of Ryan C. King*, File No. 3-15736, Order (Jan. 28, 2015).

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, 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 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 counterparty 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 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

POINT I

The Commission committed structural error by designating a presiding ALJ who was not appointed pursuant to the Appointments Clause.

The ALJ, designated to preside over Mr. Gonnella's hearing (*See* SEC Order Redesignating Presiding Judge, June 30, 2014), was not appointed pursuant to the Appointments Clause, art. II, § 2, cl. 2 of the U.S. Constitution. *See e.g.*, *Hill v. SEC*, 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015) ("the SEC concedes that

Plaintiff's ALJ, James E. Grimes, was not appointed by an SEC Commissioner").

Recent decisions from sister Circuits issued after the ALJ's Initial Decision and after briefing had concluded before the Commission in 2015 have brought this constitutional issue fully into the light. The import of this recent jurisprudence cannot be overstated – Mr. Gonnella's underlying agency enforcement action was unconstitutional.

On December 27, 2016, the Tenth Circuit set aside a SEC enforcement action because the designated ALJ was not appointed under the Appointments Clause: "The SEC's power to review its ALJs does not transform them into lesser functionaries. Rather, it shows th[at] ALJs are inferior officers subordinate to the SEC commissioners. The SEC ALJ held his office unconstitutionally when he presided over [the] hearing." *Bandimere v. SEC*, 844 F.3d 1168, 1188 (10th Cir. 2016).

The *Bandimere* Court's analysis is instructive:

> The Appointments Clause embodies both separation of powers and checks and balances. By defining unique roles for each branch in appointing officers, the Clause separates power. It also checks and balances the equal appointment authority of each branch by providing (1) the President may appoint principal officers only with Senate approval and (2) Congress may confer appointment power over inferior officers to the President, courts, or department heads but may not itself make appointments.

Id. at 1172 (internal citations omitted). The Court recognized further that there are

public policy goals underlying the Appointments Clause. "It promotes accountability by identifying public officials who appoint officers," [*Id.*], and "prevents the diffusion of that power by restricting it to specific public officials." *Id.* at 1172-73 ("The Framers understood that by limiting the appointment power, they could ensure that those who wielded it were accountable to political force and the will of the people."). Citing to 150 years of Supreme Court jurisprudence, *Bandimere* identified the following officers as "inferior:" district court clerk, assistant-surgeon, federal marshal, Naval cadet-engineer, circuit court commissioner, vice-counsel, extradition commissioner, commissioner in a district court, postmaster first class, Federal Election commissioner, independent counsel, tax court special trial judge, and military judge. *Id.* at 1173-74 (internal citations omitted).

Bandimere applied *Freytag v. Commissioner of Internal Revenue Service*, [501 U.S. 868 (1991)], which considered whether the Tax Court had authority to appoint special trial judges as inferior officers under the Appointments Clause, or alternatively, whether these judges were employees who need not be so appointed. *Id.* at 1174. There, the Supreme Court determined that the Tax Court was a court of law under the Appointments Clause with the authority to appoint inferior officers, and that special trial judges were inferior officers, and not lesser-

functioning employees, based on their duties and functions. *Id.* at 1174-76.

In *Bandimere*, the SEC conceded that "ALJs are not appointed by the President, a court of law or the head of a department," but argued that SEC ALJs are employees, not inferior officers under the Appointments Clause. *Id.* at 1176. *Bandimere* rejected this argument based on *Freytag*, which held that special trial judges were inferior officers (and not employees) based on three characteristics – which as analogized to SEC ALJs, established that: "(1) the position of SEC ALJ was established by Law; (2) the duties, salary, and means of appointment . . . are specified by statute; and (3) SEC ALJ's exercise significant discretion in carrying out . . . important functions." *Id.* at 1179 (citing *Freytag*, 501 U.S at 881-82).

First, according to *Bandimere*, the APA established the ALJ position [5 U.S.C. § 556(b)(3)], and the Exchange Act authorized the SEC to delegate to ALJs any functions with the exception of rule-making [15 U.S.C. § 78d-1(a)]. *Id.* at 1179. Second, SEC ALJs' duties, salaries, and means of appointment are set forth in statutes. *Id.* ("SEC ALJs are not hired on a temporary, episodic basis . . . [t]hey receive career appointments and can be removed only for good cause."). Third, and perhaps most importantly for our present discussion, SEC ALJ's exercise important functions commensurate with the special trial judges (as inferior officers) of the Tax Court per *Freytag*.

SEC ALJs, under 5 U.S.C. § 556 and relevant sections of Title 17 of the CFR, exercise significant discretion: (1) "authority to do all things necessary and appropriate to discharge his or her duties;" (2) authority to shape the administrative record by taking testimony, (3) regulate document production and subpoenas, (4) rule on the admissibility of evidence, (5) rule on dispositive and procedural motions, (6) issue subpoenas, (7) preside over "trial-like" hearings, and (8) make credibility findings which the SEC "affords considerable weight during agency review." *Id.* at 1178-80. ALJs also make witness credibility determinations.

Most importantly, SEC ALJs issue initial decisions, make liability determinations, and impose sanctions, which become final if the respondent does not appeal *Id.* at 1180. "Even when a respondent timely seeks agency review, the agency may decline to review initial decisions adjudicating certain categories of cases." *Id.* Further, SEC ALJ's have the power to enter default judgments, require attendance at settlement conferences, and the authority to set aside, make permanent, limit, or suspend temporary sanctions that the SEC itself has imposed. *Id.* at 1180. Based on the application of *Freytag*, *Bandimere* held with confidence that SEC ALJs are not employees, but are instead, inferior officers that must be appointed under the Appointments Clause:

This holding serves the purposes of the Appointments Clause:

> The current ALJ hiring process whereby the OPM screens applicants, proposes three finalists to the SEC, and then leaves it to somebody at the agency to pick one, is a diffuse process that does not lend itself to the accountability that the Appointments Clause was written to secure. In other words, it is unclear where the appointment buck stops. The current hiring system would suffice under the Constitution if SEC ALJs were employees, but we hold under *Freytag* that they are inferior officers who must be appointed as the Constitution commands. As the Supreme Court said in *Freytag*, "The Appointments Clause prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint."

Id. at 1181-82 (citing *Freytag*, 501 U.S. at 880).

Bandimere's opinion had split with the D.C. Circuit's view four months earlier. *Raymond J. Lucia Companies v. SEC*, 832 F.3d 277 (D.C. Cir. Aug. 9, 2016) (holding that SEC ALJs were employees, and not inferior officers under the Appointments Clause). However, on February 16, 2017, the D.C. Circuit vacated its previous judgment and ordered briefing before the *en banc* Court from March 10 to April 24, 2017 on this question: "Is the SEC administrative law judge who handled this case an inferior officer rather than an employee for the purpose of the Appointments Clause of Article II of the Constitution?" *See Lucia*, Case No. 15-1345, Order (D.D.C. Feb. 16, 2017), 2016 U.S. App. LEXIS 14559 (scheduled for argument on May 24, 2017).

On March 13, 2017, the SEC moved the Tenth Circuit for a Petition for Rehearing or Rehearing En Banc, but this request is pending. *Bandimere*, Case

No. 15-9586 (filed Mar. 31, 2017). At this time, with the D.C. Circuit having vacated its opinion that SEC ALJs were employees and not inferior officers subject to *en banc* review, *Bandimere* is the clarion call on *Freytag's* applicability and the separation of powers ruling that SEC ALJs are inferior officers who must be appointed under the Appointments Clause.

Other circuits have had occasion to consider, but have declined to address the question of whether SEC ALJs are employees or inferior officers based on justiciablity grounds. On June 17, 2016, the Eleventh Circuit, in a collateral challenge to a SEC enforcement matter that ALJ James E. Grimes presided over, held that an Appointments Clause challenge, while actionable, should "be resolved first in the administrative forum, not the district court, and then, if necessary, on appeal to the appropriate federal court of appeals." *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016). On June 1, 2016, this Circuit, in *Tilton v. SEC*, 824 F.3d 276, considered a collateral challenge to an SEC enforcement action brought in the Southern District on the same challenge. The Second Circuit, like the Eleventh Circuit, denied the collateral challenge, but held that "the appellants will have access to meaningful judicial review of their Appointments Clause claim through administrative channels." *Id.* at 286.

As this Court is aware, Petitioner Gonnella did not raise this

constitutional challenge in the administrative proceedings below. *See* Petitioner's Motion to Remand Appeal, ECF 36 (filed February 23, 2017) (denied on April 11, 2017). *Bandimere* post-dated this agency enforcement action. However, as *Freytag* underscores, "[t]he roots of the separation-of-powers concept embedded in the Appointments Clause are structural and political." *Freytag*, 501 U.S. at 878.

Mr. Gonnella's failure to raise a structural defect in the SEC administrative proceeding does not constitute waiver. The very Appointments Clause challenge in *Freytag* was not raised below, yet the Supreme Court properly exercised jurisdiction. As *Freytag* illustrates, constitutional defects to the composition of an adjudicative body are structural, and may be considered on appeal irrespective of an objection below:

> It is true that, as a general matter, a litigant must raise all issues and objections at trial. But the disruption to sound appellate process entailed by entertaining objections not raised below does not always overcome what Justice Harlan called "the strong interest of the federal judiciary in maintaining the constitutional plan of separation of powers." We conclude that this is one of those rare cases in which we should exercise our discretion to hear petitioners' challenge to the constitutional authority of the Special Trial Judge.

Id. at 879; *Nguyen v. United States*, 539 U.S. 69, 80-81 (2003) (holding that petitioner's failure to object to the composition of a panel in the court of appeals did not waive the structural challenge on appeal). For the reasons expressed above, Mr. Gonnella's adjudication before the SEC was structurally defective, and like

Bandimere, must be set aside.

POINT II

> The Commission violated Due Process and otherwise erred as a matter of law by permitting the ALJ to create independent evidence and conduct independent fact-finding after the close of the evidence and without providing Petitioner with notice and an opportunity to be heard.

The ALJ engaged in *sua sponte* research and a prosecutorial exercise of power to admit facts into the administrative record after the close of evidence. A material fact in dispute was the degree to which trading in this esoteric, illiquid bond market was subject to negotiation. Mr. Gonnella testified that price negotiation was atypical in the small universe of traders. (T 545, 566, 776-77) (explaining why he and Mr. King did not negotiate price). However, after the close of evidence, the ALJ independently found and cited to commentators from relatively obscure law reviews and from an SEC order in a case to introduce contrary facts in his Decision:

> In an illiquid market, it is reasonable to expect increased price negotiation. *See* Stephen M. Mcjohn [sic], *Default Rules in Contract Law as Response to Status Competition in Negotiation*, 31 Suffolk U. L. Rev. 39 n.83 (1997) (relying on David. D. Haddock & Fred S. McChesney, *Bargaining Costs, Bargaining Benefits, and Compulsory Nonbargaining Rules*, 7 J. L. Econ. & Org. 334, 334 & n1. (1991) . . .
>
> **Given these facts,** one would expect that in arms-length transactions, King and Gonnella would engage in price negotiation and that Gonnella would use his firm's size and his experience and knowledge to his advantage. Yet, these things did not occur . . . That Gonnella dictated prices to

> which King acquiesced further shows that the transactions were part of a sham. *See Joel L. Hurst*, Exchange Act Release No. 41165, 1999 SEC LEXIS 506, at *4 (Mar. 12, 1999) ("Hurst dictated the prices on the parking transactions. The other firms acquiesced in these price setting transactions. Therefore, the trades involving the other dealers were fictitious, non-bona fide transactions.") This **final set of factors** thus **evidences** Gonnella's bad faith and that he was trading for his own benefit with Barclay's capital.

(ALJ Decision at 23-24) (emphasis added). The ALJ's actions thus, without foundation as to expert qualifications and without cross-examination concerning the content, quality and applicability of the purportedly expert opinion, found and admitted this opinion into the record without notice to the parties. The ALJ denied Mr. Gonnella the opportunity to rebut these expert "facts," "final set of factors," and "evidence[]." (ALJ Decision at 23-24). The ALJ's conduct was designed to fill the obvious gaps in the Division's case, and in so doing, he assumed the role of a prosecutor.

The Commission acknowledged that the ALJ "found and cited commentators from relatively obscure law reviews" but declined to address this issue because "[w]e have not relied on any of the cited law review articles in reaching our decision in this case." (Comm'n Op. at 16, n. 48). Based on these casual remarks in a footnote (implying harmless error), the Commission demurred: "We need not address Gonnella's belief that this was improper." (Comm'n Op. at 16, n. 48). It was improper, and it undermined the integrity of the entire

adjudication.

"Procedural due process imposes constraints on governmental decisions which deprive individuals of "liberty" or "property" interests within the meaning of the Due Process Clause of the Fifth or Fourteenth Amendment." *Mathews v. Eldridge*, 424 U.S. 319, 332 (1976). The "right to be heard before being condemned to suffer grievous loss of any kind, even though it may not involve the stigma and hardships of a criminal conviction, is a principle basic to our society." *Joint Anti-Facist Comm. v. McGrath*, 341 U.S. 123, 168 (1951) (Frankfurter, J., concurring).

These Due Process principles are incorporated by statute in the APA. An ALJ may not "consult a person or party on a fact in issue, unless on notice and an opportunity for all parties to participate." 5 U.S.C. § 554(d)(1). An ALJ is presumed to be impartial, and is likewise prohibited from engaging in prosecutorial functions. *See e.g.*. 5 U.S.C. § 554(d)(2) (an ALJ may not 'be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for an agency.")

A respondent must have notice of all "the matters of fact and law asserted" [5 U.S.C. § 554(b)(3)] and an opportunity to participate in their defense [§554(c)]. This is because "[t]he fundamental requisite of due process of law is the

opportunity to be heard," [*Grannis v. Ordean*, 234 U.S. 285, 394 (1914)], "at a meaningful time and in a meaningful manner" [*Armstrong v. Manzo*, 380 U.S. 545, 552 (1965)].

Under 5 U.S.C. § 706, the ALJ abused his discretion by inserting additional facts into the record concerning *mens rea* – i.e. whether "Gonnella acted intentionally" or in "bad faith." (ALJ Decision at 22, 24). The independent investigation and reliance on purported expert opinions on the frequency of negotiation in this illiquid, esoteric asset-backed securities market violated procedural due process principles and the APA. It was arbitrary, not in accordance with law, and in excess of statutory jurisdiction. 5 U.S.C. § 706(2). Moreover, it is irrelevant whether the Commission relied on this *ultra vires* action. The ALJ's conduct substantially prejudiced Mr. Gonnella. The ALJ directly engaged in the "performance of investigative or prosecuting functions for an agency." *See e.g.*. 5 U.S.C. § 554(d)(2).

The Commission has the discretion on *de novo* review to disregard an ALJ's finding of fact or conclusion of law, but it should not have the discretion to disregard an ALJ's course of conduct in engaging in prosecutorial functions for the Agency. The Commission's Opinion and Order rests on a faulty foundation – the ALJ's findings of fact and conclusions of law, upon which the Commission relied

in whole or in part, are undeniably tainted. This is no harmless error.

POINT III

The Commission (a) violated 5 U.S.C. § 553 by pursuing a cooperation agreement under 17 C.F.R. § 202.12, a regulation promulgated outside of public notice and comment, that has a substantial impact on the rights of individuals and otherwise; and (b) as the prosecutorial agent, violated Due Process and erred as a matter of law by deferring decision on the penalty for a cooperating witness until after he testified in contradistinction to the process in Article III courts where independent judges, and not the prosecutors, sentence cooperators after their testimony to ensure reliable fact-finding.

Mr. Gonnella's matter is the SEC's "first litigated action that featured testimony from someone we [the SEC] signed up as a cooperator." *See* Andrew Ceresney, Director, Division of Enforcement, Remarks: "The SEC's Cooperation Program: Reflections on Five Years of Experience, at 4 (May 13, 2015) *available at https://www.sec.gov/news/speech/sec-cooperation-program.html* ("Ceresney Remarks"). The Commission announced this new cooperation program as a "policy statement" without submitting the rule to public notice and comment under 5 U.S.C. § 553. *See* SEC Release No. 34-61340, Fed. Reg. 3121, Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions, (Jan. 19, 2010). There are no reported cases addressing whether the SEC's adoption of the new program in 17 C.F.R. § 202.12 complies with the APA, separation of powers principles, or otherwise satisfies due process

and fundamental fairness.

As the test case, the Commission entered into a cooperation agreement with Ryan King and extended two favorable settlements that were contingent on his testimony. (Comm'n Op. at 16). Before King's testimony, the Commission and King agreed that he would be subject to a $24,000 disgorgement order, but withheld final judgment pending his testimony. (Comm'n Op. at 16, n. 49). After his testimony, the Commission agreed not to impose any further civil penalties on King, and dismissed any further action against him. (*Id.*).

By pre-trial motion, Mr. Gonnella objected to the use of the cooperation agreement before the ALJ arguing that the SEC's "newly-minted" cooperation program violates separation of power principles by "uniting the power to prosecute and the power to sentence within one Branch," relying on *United States v. Mistretta*, [488 U.S. 361, 391 n. 17 (1989)]. *See* Pet's Tr. Br. and Mot. in Limine at 5. Without citing to any controlling legal authority, the ALJ ruled that Mr. Gonnella's "attack on the exercise of prosecutorial discretion" and "attack on the administrative framework" have no merit. ALJ Order on Motions in Limine at 4 (July 2, 2014). Neither the ALJ's pre-trial ruling nor his Initial Decision raised 17 C.F.R. § 202.12 as the legal basis for the Commission's authority to engage King in a cooperation agreement.

Mr. King's testimony at the hearing incriminated Mr. Gonnella, notwithstanding the fact that Mr. King had provided testimony in a deposition before his cooperation agreement that was largely exculpatory. (*See* Division Exhibit 201; T 366-67, 370, 373, 390-91). Nevertheless, the new ALJ selectively validated 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. (ALJ Decision at 6 n. 13, 17 n. 26, 27).

In its Opinion, the Commission for the first time invokes 17 C.F.R. § 202.12 as the legal basis justifying SEC cooperation-style agreements where the "power to prosecute and the power to sentence" a cooperator lies exclusively in one Branch and in one agency. (Comm'n Op. at 16, n. 49) ("17 C.F.R. § 202.12 . . . set[s] forth Commission policy regarding cooperation by individuals during investigations and related enforcement actions.")). Like the Initial Decision of the ALJ, the Commission held that Mr. Gonnella's claims of a due process violation and separation of powers violation have "no legal merit." (Comm'n Op. at 17).

The SEC has heralded its new cooperation program as a "tool" that has "significant" "tangible benefits for individuals and entities in our investigations." (Ceresney Remarks at 7). The Supreme Court recently affirmed a challenge to an agency policy statement under 5 U.S.C. § 553 in *Texas v. United*

States. 136 S. Ct. 2271, 195 L. Ed. 2d 638 (June 23, 2016) (affirming 809 F.3d 134 (5th Cir. 2015)). In *Texas*, the Fifth Circuit held that a Department of Homeland Security policy statement to grant deferred action to certain undocumented immigrations violated the APA, and invoked long-standing principles of agency rule-making and the substantial impact test:

> A binding rule is not required to undergo notice and comment if it is one "of agency organization, procedure, or practice." § 553(b)(A). The substantial impact test is the primary means by which [we] look beyond the label 'procedural' to determine whether a rule is of the type Congress thought appropriate for public participation. An agency rule that modifies substantive rights and interests can only be nominally procedural, and the exemption for such rules of agency procedure cannot apply.

Texas, 809 F.3d at 176 (internal citations omitted).

Similarly, the Second Circuit, in accord with sister circuits, considers whether "a rule is subject to notice and comment requirements by focusing on whether the rule is interpretive or substantive." *White v. Shalala*, 7 F.3d 296, 303 (2nd Cir. 1993). A substantive rule is one that "grants rights, imposes obligations, or produces other significant effects on private interests, while an interpretative rule is an agency's intended course of actions, its tentative view of the meaning of particular statutory term, or internal house-keeping measures organizing agency activities." *Id.* (internal citations omitted). Thus, "[t]he central question is essentially whether an agency is exercising its rule-making power to clarify any

existing statute or regulation, or to create new law, rights, or duties in what amounts to a legislative act." *Id.* For these "legislative rules," agencies have the power to promulgate "only if, and to the extent that, Congress has so authorized." *Sweet v. Sheahan*, 235 F.3d 80, 91 (2nd Cir. 2000).

The D.C. Circuit has developed a more comprehensive test to determine whether an agency's rule has "legal effect" such that it is a legislative rule, as opposed to an interpretive rule:

> (1) whether in the absence of the rule there would not be an adequate legislative basis for enforcement action or other agency action to confer benefits or ensure the performance of duties, (2) whether the agency has published the rule in the Code of Federal Regulations, (3) whether the agency has explicitly invoked its general legislative authority, or (4) whether the rule effectively amends a prior legislative rule. If the answer to any of these questions is affirmative, we have a legislative, not an interpretive rule.

Id. (citing *Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

The importance of public notice and comment to the rules governing adversarial proceedings cannot be overstated. It is the norm, not the exception. The federal rules for civil and criminal procedure, through the U.S. Courts, are subject to public notice and comment. *See* U.S. Court's Website, "Proposed Amendments Published for Public Comment," *available at* *http://www.uscourts.gov/rules-policies/proposed-amendments-published-public-*

comment. For instance, Federal Rule of Criminal Procedure 35(b), subject to public notice and comment and amended several times from 1996 to 2009, controls when a prosecutor may move a district court for a reduction in a sentence for a cooperator. U.S. Sentencing Guideline § 5K1.1, also subject to public notice and comment, governs when a prosecutor may move the district judge for a reduced sentence pursuant to 18 U.S.C. § 3553(e). Even U.S. district courts, before adopting local rules, must give "appropriate public notice and an opportunity to comment." Fed. R. Civ. Pro. 57(a). Indeed, Congress has legislated rules governing immunity agreements for criminal prosecutions, agency enforcement proceedings, and Congressional proceedings. *See* 18 U.S.C. § 6001, *et seq.*

Notwithstanding that the rules of criminal procedure are subject to public notice and comment, the SEC's new tool is an attempt to import the protocol from criminal prosecutions, but it is missing a key component – a cooperator's sentence in a criminal case is imposed by a representative of the judiciary, appointed pursuant to Article III of the Constitution. By contrast, in 17 C.F.R. § 202.12 and as evident in Mr. Gonnella's test case, the Commission by policy fiat has arrogated to itself the power to affix a cooperator's sentence after the testimony and without any similar check or balance on prosecutorial excess.

Section 202.12 confers significant, tangible benefits on parties, and the

SEC did not submit the rule for public notice and comment. This circumvention of 5 U.S.C. § 553 injures both the agency and affected parties. It denied the considered expertise of lawyers, scholars, the defense bar, and other interested parties who could have identified the constitutional infirmities inherent in *any* enforcement system where the prosecutorial agent possesses both the power to prosecute and the power to punish in situations where a sanction is contingent on testimony.

Within the Article III context, this precise issue was raised before the Eighth Circuit in *U.S. v. Waterman*, [732 F.2d 1527 (8th Cir. 1985)]. There, the court considered whether "an agreement to procure testimony about accomplished facts, which places a premium on testimony adverse to a defendant, creates a risk of perjury so great that even the jury's full knowledge of the agreement is insufficient to protect the fundamental fairness inherent in the due process clause." *Id.* at 1530. A cooperation agreement violates due process where the sentence is contingent on bringing charges against others or upon the successful conviction of another. *Id.* at 1531. In the view of the court:

> [D]ue process cannot be interpreted to allow the government to reward its witnesses based upon the results of their testimony. There simply is no reason to offer a witness favorable treatment for anything other than truthful cooperation in the government's quest for justice.

Id. at 1533. The SEC's stated purpose behind 17 C.F.R. § 202.12 is to maximize

"the Commission's law enforcement interests" through "rewarding an individual's cooperation." It is a significant benefit that should proceed through the rule-making requirements of 5 U.S.C. § 553 because it is a legislative rule. *Waterman* highlights the criticality for proper rule-making: There is a fine line between rewarding a witness based on the results of his testimony and rewarding a witness for maximizing the Commission's law enforcement interests. Here, there is a violation of 5 U.S.C. § 553 because 17 C.F.R. § 202.12, the promulgation of a new program, qualifies as a substantive, legislative rule that confers substantial benefits on cooperators and implicates the due process rights of the accused. *See e.g.,* Fed. R. Crim. Pro. 35 and U.S.S.G. § 5K1. More, having the government enter into an agreement with a cooperator where his penalty would be contingent on his testimony crosses the due process line and the *Mistretta* separation of powers line *when* the government arrogates to itself the power to both prosecute and sentence the cooperator after his testimony. The cooperation program, which incentivized Mr. King to stretch the truth to please the same prosecutorial and sentencing power, undeniably prejudiced Mr. Gonnella under 5 U.S.C. § 706.

POINT IV

The Commission violated Due Process and otherwise erred as a matter of law by imposing sanctions in excess of those ordered by the ALJ and otherwise affirming disproportionate sanctions.

A permanent bar from practicing one's profession is a "severe" sanction. *Steadman v. SEC*, 450 U.S. 91, 95 n. 8 (1981); *id.* at 105 (Powell, J., dissenting). The Commission affirmed the ALJ's civil monetary penalty of $82,500, but increased a 12-month suspension ordered by the ALJ to a lifetime industry ban with the right to re-apply after five years. (Comm'n Op. at 20). For its legal basis to increase the sanction imposed by the ALJ, the Commission cited to its own decision from 2009 *In the Matter of Kornman*, Admin. Proc. File No. 3-12716, *available at https://www.sec.gov/litigation/opinions/2009/34-59403.pdf*, for the proposition that the Commission's review of sanctions is *de novo*. (Comm'n Op. at 20, n. 62). The Commission offers no other legal authority to justify why, as a matter of due process, the Commission is permitted to aggravate a sanction *after* a respondent exercises his right to appeal an initial decision of the ALJ. The public policy concern is apparent – the Commission's practice of aggravating a sanction after a respondent appeals an initial decision has a chilling effect on a respondent's constitutional and statutory rights to appeal.

The Second Circuit will find "an abuse of discretion if the sanctions imposed are either unwarranted in law or without justification in fact." *Valicenti Advisory Servs. v. SEC*, 198 F.3d 62, 66 (2nd Cir. 1999). Though there is deference to the SEC's sanction choice, "that deference is not absolute . . . [c]ourts

of appeals have in the past shown our willingness to overturn Commission penalties that we concluded were draconian." *VanCook*, 653 F.3d at 144.

This is such a circumstance. Although Commissioner Piwowar did not use the word draconian, he issued a dissenting opinion on the imposition of a permanent industry bar. (Comm'n Dissenting Op. at 1). For this, Commissioner Piwowar wrote that he has "serious concerns, on due process and other grounds, about the Commission imposing sanctions that are neither requested by the Division nor found by the ALJ to be appropriate." (Comm'n Dissenting Op. at 1). The principles in *North Carolina v. Pearce*, [395 U.S. 711 (1969)], echo these concerns as Mr. Gonnella's property interests under the Due Process Clause have been severely injured through his exercise of his right to an appeal. "The imposition of such a punishment, penalizing those who choose to exercise constitutional rights, would be patently unconstitutional. And the very threat inherent in the existence of such a punitive policy would . . . serve to chill the exercise of basic constitutional rights." *Pearce*, 395 U.S. at 724 (internal citations omitted); *id.* at 725 ("the fear of such vindictiveness may unconstitutionally deter a defendant's exercise of the right to appeal").

Mr. Gonnella has been subject to a cease-and-desist order since February 4, 2014. He has served more than the twelve-month suspension adjudged

by the ALJ on November 12, 2014. Had Mr. Gonnella not exercised his constitutional and statutory right to appeal to the Commission, he would have been able to resume his profession by now. Instead, he has been further penalized through his exercise of appellate rights. This is patently unconstitutional and unfair. At a minimum, Mr. Gonnella requests, consistent with his due process rights and in furtherance of public policy, that the Court set aside the Commission's lifetime industry ban.

POINT V

> The Commission's findings are insufficient as a matter of law to establish substantially that Petitioner *intended* to commit fraud under Securities Act Section 17(a)(1), Exchange Act Section 10(b), and Exchange Act Rule 10(b)-5(a) and (c) where the evidence adduced demonstrated that: (a) Petitioner believed his conduct was in furtherance of complying with his employer's aged-inventory policy, (b) Petitioner self-reported a violation after learning about further implications of the policy, (c) the employer determined that it was neither deceived nor defrauded by Petitioner, and (d) there was no evidence that the conduct affected Petitioner's compensation or that he believed that it did.

The Commission determined that Mr. Gonnella possessed scienter "because he knew or was reckless in not knowing that his prearranged transactions would deceive Barclays into believing that he was complying with the Policy when, in fact, he was not." (Comm'n Op. at 13). A reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be . . .

arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2). "In reviewing the SEC's opinion and order, [the Court] must affirm the findings of the Commission as to the facts, if supported by substantial evidence." *Valicenti*, 198 F.3d at 64; *see also* 15 U.S.C. § 78y(a)(4).

The Commission, relying on the Initial Decision of the ALJ (who himself improperly received additional evidence into the record after the close of the proceeding on the matter of intent (see Point II *infra.*), determined that Mr. Gonnella took steps to conceal his actions from supervisors by using vague language, using his cell phone once, executing trades while his supervisor was on vacation, and giving false statements for his conduct. (Comm'n Op. at 13). Based on these contentions, the Commission concluded that "[t]hese steps all confirm that he knew or must have known that his conduct would deceive Barclays." (Comm'n Op. at 13). The Commission further held that it need not, for fraud, find any monetary loss to Barclays; instead, in their view, "[t]he point is that, over a series of months, Gonnella engaged in a course of conduct intended to deceive Barclays without considering how Barclays might be harmed." (Comm'n Op. at 13).

The substantial evidence in the record does not support this conclusion. The Commission's decision, in relying on the work of the new ALJ, all but conceded that the ALJ erred by conducting independent investigation and

purported fact finding – all without notice, cross-examination and the opportunity to be heard in rebuttal – on the issue of intent to fill gaps in the Division's prosecutorial proof (as it declined to consider the evidence that he independently produced). Such prosecutorial zeal by a judge can never yield "substantial evidence" to support an agency determination.

Mr. Gonnella's conducted his business in plain sight, and that conduct fails to support any conclusion that he acted with any intent or purpose to deceive Barclays or anyone else, as Barclays itself so determined. Mr. Gonnella's messages to King, *monitored by compliance officers and his supervisors in the Bloomberg 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). He plainly advertised his intentions and motivations in the Bloomberg Messages, and then traded consistently with those representations. (*See* Division Exhibits 20-22). There were approximately 10 traders in this market, and Mr. Gonnella initially offered the bonds to at least five different counterparties, typically explaining that he was doing so to avoid aged inventory with an eye towards repurchasing them later. (Division Exhibit 21-22; Gonnella Exhibits SA & SB; T 39,487, 749-52, 754, 756, 759-60, 763-66, 837.) More, 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. Kind had unadvisedly assumed the risk of the bonds as a favor to Mr. Gonnella without proper assessment. (T 337-38, 406-09, 772, 777-78, 837). The prevalence of the roundtrip 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 that the ALJ ignored. (Division Exhibit 63; T 1238-40). That the practice of round-trip transactions was not uncommon almost by itself precludes the possibility that Mr. Gonnella was acting with willfulness and the requisite intent to defraud. More, it is also in plain-sight that the prices of all of the trades at issue were within the prevailing bid-ask spread. (T 507, 545, 566, 776-77, 918-27, 1129-31, 1164-65, 1333, 1380-81).

The evidence unequivocally establishes that Mr. Gonnella self-reported a concern about his trades with King in November 2011 after receiving clarification of the aged-inventory policy at an annual compliance meeting. Mr. Gonnella flagged the issue to his compliance officer, which thereafter prompted Mr. Gonnella's supervisor to escalate the matter to his supervisors. (T 1066-67, 1139, 1241, 1261-62). As further evidence of his lack of intent to defraud Barclays for his own advantage, Mr. Gonnella held some positions for far longer than seven

months, and often sold such aged securities at significant gains to Barclays. (T 129-38, 134-35, 137, 141-42, 762, 793, 796, 872; Division Exhibit 11, 24].

The evidence utterly fails to support the Commission's argument that Barclays was somehow a "victim" of Mr. Gonnella's purported "scheme" to defraud Barclays by violating its internal policy on not holding onto assets too long. Barclays conducted its own internal investigation, and it had access to virtually all of Mr. Gonnella's communications. (T 720, 1334-35). Barclays *affirmatively* found that Mr. Gonnella did not violate any securities statutes or regulations (such as parking, adjusted trading and inter-positioning), and reported on its Form U5, the Uniform Termination Notice for Securities Industry Regulation, 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). The ALJ and the Commission neglected to incorporate in its findings that Barclays selected "no" to Question 7B on the Form U5, whether the individual was "under internal review for fraud or wrongful taking of property, or violating investment-related statutes, regulations, rules or industry standards of conduct." (Gonnella Exhibit 54). Finally, the evidence in the record established that aged inventory charges had no effect on Mr. Gonnella's compensation and that he did not believe that they had such an effect. (T 474-78,

517, 787-92).

The record does not substantially establish, through a preponderance of the evidence, that Mr. Gonnella acted with an intent to deceive Barclays in violating its internal policy – he conducted this trades subject to monitoring, openly told his counter-party that he was selling the bonds to comply with the policy, often held onto bonds for more than seven months, received no financial benefit (i.e. motive) from the trades, and even addressed the matter with his compliance officer after receiving clarification about the scope of the internal policy. Most importantly, the purported victim, Barclays, reported to FINRA that it did not believe Mr. Gonnella violated any securities laws.

POINT VI

The Commission's findings are insufficient as a matter of law to establish substantially that Petitioner *actually* committed fraud where the evidence did not show that the trades at issue could be considered stock-parking because (a) beneficial ownership and risk of loss in fact passed, and (b) the limited nature of the trades in this relevant, esoteric illiquid market, distinguishes it from true stock-parking in far more liquid markets.

The Commission contends that Mr. Gonnella's trading defrauded Barclays because it violated their internal aged inventory policy, and met the definition of parking. (Comm'n Op. at 12 n. 26). The Commission held that "his trades did not reflect an attempt to *actually* comply with the Policy. Rather, the

trades were an attempt to *appear* to comply with the Policy so that Gonnella could avoid incurring irreversible aged inventory charges while maintaining bonds in his portfolio." (Comm'n Op. at 11).

The Commission's finding ignores the reality of this unique marketplace, and is internally inconsistent with other findings in their record. The Commission correctly determined that Mr. Gonnella traded in esoteric, asset-backed securities that were "traded over-the-counter by a limited number of market participants," [Comm'n Op. at 3) and that for the trades at issue, the risk of ownership did, in fact, pass from Barclays to Gleacher. (Comm'n Op. at 11). The Commission's argument is that because Mr. Gonnella violated an internal policy – intentionally in their view – he committed a fraud. Again, this belies the record. Ownership passed to Gleacher, and roundtrip trades were common in this limited marketplace.

Further, Mr. Gonnella's trades did not constitute stock parking. The pivotal question is not whether a limited universe of participants in an illiquid market like esoteric asset-backed securities expect that the same assets will be traded back and forth between them – the inevitable dynamic in such a market, but whether the parties agree that beneficial ownership (embracing risk of loss and the right to principal and interest) remains with the seller at the time of a "sham" sale.

See Yoshikawa v. SEC, 192 F.3d 1209, 1210-11 (9th Cir. 1999); *United States v. Jones*, 900 F.2d 512, 515 (2nd Cir. 1990); *United States v. Russo*, 74 F.3d 1383, 1388 (2nd Cir. 1996). In *Yoshikawa*, 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.

Yoshikawa, 192 F.3d at 1211.

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). Per the Commission's flawed reasoning, beneficial ownership did not *really* pass to Gleacher, because of its perceived arrangement to repurchase the bonds, but that reasoning has it backward: the Commission 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, Barclays, or the investing public because the economic incidents of ownership in fact passed to Gleacher. Accordingly, his conduct does not constitute parking.

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 securities transactions become parking only when, independent of whether an improper motive exists, they are not "actual, bona fide transactions just like any other in the marketplace." *Id; Cf. ATSI Communications, Inc. v. The Shaar Fund, Ltd.*, 493 F.3d 87, 101 (2d Cir. 2007) (no manipulation where real transactions that passed ownership); *GFL Advantage Fund, Ltd. v. Colkin*, 272 F.3d 189, 207, 210 n. 10 (3d Cir. 2001) (no manipulation where sales "on the open market in legitimate transactions to real buyers").

As in *Yoshikawa*, that Mr. Gonnella ended up repurchasing the bonds shortly after he sold them is not relevant or illegitimate in itself, 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. Mr. Gonnella's trades, (well-intended) violated the aged-inventory policy, but there was no pre-agreement, and the violation of an internal employer policy is not fraud under these circumstances.

POINT VII

The Commission's findings are insufficient as a matter of law to establish substantially that Petitioner actually aided, abetted, and caused his employer's violations of the books and records provisions of Exchange Act Section 17(a) and Exchange Act Rule 17a-3(a)(2) because there was no fraud.

Because Mr. Gonnella did not engage in pre-arranged trades or stock parking also compels the conclusion that it failed to prove that Mr. Gonnella aided and abetted the creation of false books and records, which the Commission alleges constituted a violation of Section 17(a) of the Exchange Act and Rule 17a-3. Mr. King, prior to his cooperation agreement, testified truthfully 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). There was no pre-arrangement that had to be disclosed.

CONCLUSION

The Court should set aside the Opinion and Order of the Commission pursuant to the structural errors arising from the violation of the Appointments Clause and the other constitutional and statutory infirmities. The ALJ became a prosecutor, and the Commission heavily relied on his Initial Decision. The SEC's new cooperation program violates separation of powers principles, and a respondent should never be penalized for exercising his right to appeal.

Finally, the Court should set aside the findings of the Commission as the preponderance of the evidence does not establish that Mr. Gonnella intended to defraud Barclays by violating a company policy, actually defrauded Barclays, or that Barclays, was, in fact, defrauded.

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitations in Fed. R. App. P. 32(a(7)(B0 because this brief contains 13,886 words, excluding the parts of the brief exempted by Fed. R. App. 32(a)(7)(B)(iiii)

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