BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Edward S. Brokaw Darien, CT, Respondent.	DECISION Complaint No. 2007007792902 Dated: September 14, 2012

Respondent failed to conduct an adequate inquiry to ensure that a customer's trading instructions were not for a manipulative purpose and failed to ensure that accurate customer order tickets were completed. Held, findings and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Lane A. Thurgood, Esq., Margaret M. Tolan, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Kevin T. Hoffman, Esq.

Decision

Edward S. Brokaw ("Brokaw") appeals the Hearing Panel's decision in this matter.[1] In that decision, the Hearing Panel found that Brokaw violated Section 10(b) of the Securities

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[1] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57*, 2008 FINRA LEXIS 50 (Oct. 2008). Because the complaint in this case was filed before December 15, 2008,

[Footnote continued on next page]

Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110 by engaging in a market manipulation. The Hearing Panel also found that Brokaw violated NASD Rules 3110 and 2110 when he caused his firm's books and records to be inaccurate by failing to ensure the completion of accurate customer order tickets. The Hearing Panel barred Brokaw.

After a complete review of the record, we modify the Hearing Panel's findings of violation and the sanctions imposed. We reverse the finding that Brokaw engaged in a manipulation and find instead that he failed to conduct an adequate inquiry into a customer's trading instructions, in violation of NASD Rule 2110. We affirm the books and records violation. For the NASD Rule 2110 violation, we suspend Brokaw for one year and fine him $25,000. We concurrently suspend him for 30 business days and fine him an additional $5,000 for the books and records violation.

I. Background

Brokaw entered the securities industry in 1983 when he registered as a general securities representative. Brokaw was associated with several FINRA member firms since he entered the securities industry. Brokaw was last registered with a FINRA member firm in June 2010.

II. Procedural History

This case arose out of the Department of Enforcement's ("Enforcement") investigation of Deutsche Bank Securities, Inc.'s ("Deutsche Bank" or the "Firm") termination of Brokaw on June 28, 2006. Deutsche Bank terminated Brokaw as a result of him executing trades in Monogram Biosciences, Inc. ("MGRM") for one institutional customer on three successive trading days in May 2006. Enforcement's case rested largely upon tape-recorded conversations between Brokaw and Deutsche Bank's sales traders occurring when Brokaw placed large orders to sell MGRM common stock near the open and close of the market for Tang Capital Partners ("the Fund"), a hedge fund that invested in biotech securities, and its principal owner KT.

Enforcement filed a three-cause complaint against Brokaw on December 12, 2008. The first cause of the complaint alleged that Brokaw manipulated, or alternatively aided and abetted KT's manipulation of, the price of MGRM's shares, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110. Cause two, an alternative charge to cause one, alleged that Brokaw failed to conduct an adequate inquiry into whether KT's instructions to sell MGRM stock were for a manipulative purpose, in violation of NASD Rule 2110. The third cause alleged that Brokaw failed to ensure that accurate order

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the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

tickets were completed for KT's sales of MGRM stock, which caused Deutsche Bank's books and records to be inaccurate, in violation of NASD Rules 3110 and 2110.

After a six-day hearing, the Hearing Panel found that Brokaw placed orders to sell MGRM stock on KT's behalf at the open and close of the market for the purpose of increasing the value of MGRM's contingent value rights ("CVR"). The Hearing Panel concluded that Brokaw therefore manipulated the price of MGRM in violation of the antifraud provisions as alleged in cause one of the complaint.[2] The Hearing Panel further found that Brokaw failed to ensure the accuracy of order tickets as alleged in cause three. The Hearing Panel barred Brokaw for the manipulation and imposed no sanction for the books and records violation due to the bar. Brokaw's appeal to the National Adjudicatory Council ("NAC") followed.

The NAC submitted its draft decision to the FINRA Board of Governors, and the Board called the case for discretionary review.[3] This matter is now before the NAC on remand from the Board.

III. Facts

A. MGRM and Its Contingent Value Rights

In 2004, ACLARA BioSciences, Inc. ("ACLARA") and ViroLogic, Inc. merged to form MGRM. Under the terms of the merger, each outstanding share of ACLARA common stock was exchanged for 1.7 shares of MGRM common stock and 1.7 MGRM CVRs. The CVRs traded on the open market as an independent security. Each CVR represented the right to receive a payment up to a maximum of $0.88 per CVR depending on the volume weighted average price ("VWAP") of MGRM common stock traded during a pricing period.[4] The pricing period spanned the 15 consecutive trading days immediately preceding June 10, 2006 (May 19, 2006, to

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[2] Because the Hearing Panel found that Brokaw directly violated the antifraud provisions, it dismissed the aiding and abetting allegations asserted in cause one of the complaint and the related alternative allegations of violations of NASD Rule 2110 under cause two.

[3] FINRA Governor Seth H. Waugh was recused and took no part in this matter.

[4] The CVR agreement set forth that the VWAP was determined at the end of each trading day during the pricing period by determining the "volume weighted mean of the sales prices . . . on The Nasdaq Stock Market . . . on such trading day, as quoted by Bloomberg LP." VWAP is ordinarily calculated by "breaking the day's transactions into groups according to the price at which the security was traded, and then multiplying each price times the number of shares traded at that price, and dividing the total of these products by the total number of shares traded for the day." *Allis-Chalmers Mfg. Co. v. Gulf & W. Indus.*, 527 F.2d 335, 353 n.19 (7th Cir. 1975).

June 9, 2006).[5] If, at the end of the pricing period, MGRM's average VWAP was above $2.90, the CVR holders received nothing. If the average VWAP was $2.02 or below, the CVR holders would receive the maximum payout of $0.88 per CVR. If the average VWAP was between $2.03 and $2.90, the CVR holders would receive the difference between $2.90 and the VWAP price.

On May 8, 2006, 11 days before the beginning of the pricing period, MGRM announced that Pfizer intended to invest $25 million in MGRM. The announcement had an immediate effect on MGRM's stock price. The common stock price climbed as high as $2.42 the day of the announcement before closing that day at $2.30. The stock's daily trading volume soared to 15,884,679 from volume that ranged between 241,452 and 695,293 shares traded the week before. Even with this news, however, the average VWAP of MGRM for the 30-, 60-, and 90-day trading periods leading up to the pricing period was below the $2.02 bench mark.[6] On May 12, 2006, four days after the Pfizer announcement, MGRM's stock price dropped to a daily low of $1.97. On the first day of the pricing period, May 19, 2006, MGRM's stock price fell to a daily low of $1.90.

B. Brokaw's Relationship with KT

Brokaw met KT when the two worked together at another brokerage firm. At that time, KT worked as a research analyst focusing on the biotech sector. After leaving this firm, KT formed the Fund. KT used brokers at various firms to execute trades for the Fund, including Brokaw and Deutsche Bank. KT was one of Brokaw's biggest customers and was very important to his business.

C. KT's and Brokaw's MGRM Holdings

KT was also an ACLARA board member, held shares of both ACLARA and ViroLogic before the merger, and was involved in negotiating the terms of the merger, including those related to the CVRs. Following the merger, the Fund owned more than 7.9 million shares (approximately 6.3%) of MGRM's common stock and received eight million CVRs. In the period between the CVRs' creation in December 2004 and the pricing period, the Fund purchased 10.5 million additional CVRs thereby amassing a total of 18.5 million CVRs.

KT began selling the Fund's MGRM holdings in late 2004. From December 2004 until May 18, 2006, the Fund sold 4,864,400 shares of MGRM common stock, which represented 62% of its MGRM stock holdings. KT's trading objective with respect to MGRM was to capture a perceived inefficiency between the MGRM common stock and the CVR. KT believed that the

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[5] MGRM had the option to pay a percentage of the CVR payout in the form of MGRM stock. On May 26, 2006, MGRM announced that it intended to make any CVR payment that became due in cash.

[6] The respective VWAPs were $1.76, $1.84, and $1.88.

CVR was undervalued relative to the company's stock price. KT had a "bearish" view on the fundamentals of MGRM and bought more CVRs for the Fund than it owned stock. The smaller long position in MGRM stock partially hedged the Fund's CVR position. KT stated that "buying the CVR was, in essence, a negative bet on where [MGRM] stock was going to go." The Fund therefore "overweighted the CVRs versus the stock in order to have a net bearish view," and "to capture the inefficiency in the pricing between the two securities." The Fund planned to sell the remainder of its MGRM common stock by the end of the pricing period to avoid being exposed on either side of the hedge. The evidence shows that, during the pricing period, KT for the Fund, through Deutsche Bank and other broker-dealers, sold 2.95 million shares of MGRM common stock, resulting in a 300,000 share short position by the pricing period's close.

Brokaw also owned MGRM stock and CVRs as a result of holding ACLARA stock through the merger with ViroLogic and buying additional CVRs in the open market. By late 2005, Brokaw had sold all of his MGRM stock, but he and his family continued to hold 215,690 CVRs. Brokaw did not trade MGRM shares for himself or anyone other than KT during the pricing period.

D. KT's Trading on May 19, 2006

On the morning of May 19, 2006, the first day of the pricing period, KT placed a market order with Brokaw to sell 50,000 shares of MGRM at the open and another 50,000 shares at the close. KT testified that he had a level of urgency around his MGRM orders because he had approximately three million shares that he wanted sold by June 9, 2006. Unbeknownst to Brokaw, KT also was simultaneously selling an additional 200,000 MGRM shares per day through two other broker-dealers in order to ensure that the Fund's three million shares were liquidated during the pricing period.[7]

Brokaw called Deutsche Bank sales trader Jennifer Watson ("Watson") to convey KT's order. The colloquy between Brokaw and Watson related to this order was recorded as follows:

Watson: Hey, what's going on?
Brokaw: Hey, uh, for [KT].
Watson: Ahaha.
Brokaw: This is going to be a real easy order.
Watson: [Expletive].
Brokaw: No, it is. Take 50,000 MGRM at the market. Sell it down. Sell it as low as you want. Sell it hard, 50,000.
Watson: Is this a, uh, revenge thing?

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[7] KT testified that he used other broker-dealers to execute his MGRM sales to diversify the risk if Deutsche Bank failed to execute his order, which had happened in the past; to pay commissions to different firms that provide different services to him and "to capture more [order] flow"; and to disguise his trading strategy by not giving one firm a "huge, gigantic order."

Brokaw: This is revenge of the nerds, exactly.
Watson: All right, selling 50,000 market at (inaudible) MGRM.
Brokaw: Yeah, if you report it at one cent, you report this thing at one cent, that would be good, okay?
Watson: Oh, I can't do that.
Brokaw: All right, just get 50,000 done and let me know, all right?
Watson: Gotcha.
Brokaw: Just sell it hard. Bye.[8]

Deutsche Bank equity trader Chad Messer ("Messer") executed KT's order immediately after the open at prices from $2.06 to as low as $1.91.

At 9:33 a.m., Watson called Brokaw's sales assistant, Will Ewing ("Ewing"), to report execution of the sale of 50,000 shares at an average price of $1.9574 per share. Ewing told Watson: "[W]e'll be coming back in at the close." Watson asked: "At the close you're coming back with 50? What are you guys up to today?" Ewing responded: "[KT's] trying to, you know, they're, anyways, [KT's] doing his thing." At 9:36 a.m., Brokaw called Watson to reiterate that "you got another 50 to sell at the end of the day." He added: "[T]hey're all set up on these CVRs. Do you realize what's going on here?" Watson indicated that she had to get off the call, and Brokaw told her to call back and that he would explain it.

At 2:09 p.m., Brokaw again called Watson and gave her further instructions regarding the afternoon order:

Brokaw: [A]t about ten of put the other 50 in and work it down.
Watson: 10 of three or 10 of four?
Brokaw: 10 of four or five of four, whatever you want to do depending on —
Watson: But you just want it close to the close.
Brokaw: [KT] wants it close to the close, and you did a great job hammering, and they all just want to hammer it again today to do the wakeup call here. So what's happening, so you know what's happening, is there's these rights that are out there which are the MGRMRs . . . . And they start pricing off of the average over the next 15 days. Do you follow me?[9]
Watson: Uh, I think so.
Brokaw: Okay. So the trader ought to be aware of this.
Watson: Well we've had somebody else selling for a few days now.

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[8] Brokaw testified that he was "being very glib" on this call, but was trying to express the aggressive nature of the order. Brokaw stated that KT placed significant pressure on him to "get[ ] the order done quickly" and without price sensitivity. Brokaw testified that, in retrospect, he did not effectively communicate that KT's order was an aggressive market order on the open and that the trader was to "get it done, don't sit on it."

[9] KT testified that "hammering" the stock was not his language but rather Brokaw's interpretation of KT's instructions "to get [the order] done" during the "allotted time frame."

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Brokaw: I can tell you he wants at the end of the day, he wants to be net short this stock which he will end up doing.
Watson: So he's going to sell more than he owns because of the rights.
Brokaw: And he owns a ton of the rights, right. So and the math works that is the closer at 2.02 you get to, uh, the full value of the rights are realized at 2.02 on the stock.
Watson: Okay.
Brokaw Just so you know what the target price is, and I'm sure Chad [Messer] knows that, but if he doesn't and he wants me to go through it with him, I'll explain it to him so he understands.
Watson: You're a good person.
Brokaw: So, yeah, understand the game that's being played for the next 15 days. It's good versus evil. . . . the company versus us because, see, the company issued these things thinking they would never . . . typical, um, [expletive], you know, optimistic company, and um you know that the point here is that they do this and then they turn around and … never succeed on anything that they promised everyone, and that's why the stock went to a buck-fifty, and then what they did is they got this deal for Pfizer done which moved the stock, and their whole goal here is to keep the stock up while they do this pricing period because, you know, obviously the higher the stock is, the less the CVR they have—the less cash and stock they potentially have to pay out. So that's the whole key. It's a sliding scale from 2.02 to 2.90. At 2.90, they owe the CVRs nothing. At 2.02, they owe, they owe them everything, 88 cents. You follow me?
Watson: Yeah.
Brokaw: So that's why the game is being played the way it is.
Watson: Aha.

Watson conveyed KT's order to Messer, stating that she had an order to sell 50,000 shares of MGRM in the last two minutes of trading. Watson told Messer that she wanted to do what the client asked but "without putting price pressure on the stock." In response, Deutsche Bank executed KT's order over the 11 minutes leading up to the close at prices declining from $2.14 to $2.01 rather than in the minute or so before the close.

The VWAP of MGRM on May 19 was $2.08, with a trading volume of more than 2 million shares. KT's 300,000 share sale represented just fewer than 15 percent of the total shares traded that day.

E. KT's Trading on May 22, 2006

KT placed another order with Brokaw on the following trading day, May 22, 2006, with instructions to aggressively and quickly sell 50,000 shares of MGRM at the open. KT again told Brokaw he would be back at the close to sell more. KT wanted 50,000 MGRM shares sold

within the first five minutes of trading on that day. Brokaw directed Ewing to relay the order to the trading desk. At 9:20 a.m., Ewing called Deutsche Bank sales trader David Zitman ("Zitman") with KT's order. Ewing told Zitman: "We got 50,000 this morning and 50,000 this afternoon . . . and he wants to sell 50,000 on the, uh, opening and sell it hard." Ewing continued: "[H]e's trying to—he, he owns the rights and—they're pricing the rights off the stock." Brokaw then signaled to Ewing to "knock it off." Ewing said to Zitman: "Sorry, sorry, enough said, I'm not, that's, I'm not supposed to be going into that. Anyways, he's trying to, he wants to sell."[10] Ewing then urged Zitman to "sell it hard and, you know, sell it on the opening. . . . [KT] wants it sold hard in the morning." Zitman confirmed "it's a market order and he wants to be done on 50 ASAP." Zitman said he would give the order to equity trader Messer, expressing the "hope that he knows what he's talking about. Because . . . I'm not . . . real clear on what you're . . . asking me to do." Zitman entered KT's order at 9:22 a.m.

Zitman called Brokaw's office at 9:26 a.m. and informed Ewing that he had given KT's order to Messer with instructions to "trade it like you been trading it last week." Zitman then spoke with Brokaw to confirm KT's instructions:

Zitman:	This guy wants to sell the crap out of, it's a market order.
Brokaw:	Look, it's a market order.
Zitman:	Market order—take the [expletive] thing down (inaudible) a dollar?
Brokaw:	Yeah, 50 cents, yes.
Zitman:	He wants it to be done on the opening?
Brokaw:	Pretty much, yeah, market order.
Zitman:	He wants it to be done and if I take the thing down to $1.50 and it bounces back to $2, he doesn't care.
Brokaw:	No, right.
Zitman:	He wants me to sell it hard.
Brokaw:	Yeah, just sell market order, yeah. Market order is market order.

Zitman wanted Brokaw to understand that a large market order such as this one executed at the open could cause MGRM's share price to move drastically. Within two minutes of the open, KT's order was executed at prices declining from $1.95 to $1.91.

At 3:22 p.m., Zitman called Brokaw's office to confirm KT's afternoon order to sell 50,000 additional MGRM shares.[11] Ewing told Zitman that the day's second order was "going to be like literally, you know, as late as you can." Zitman confirmed "50,000 market on close." Messer, however, did not execute the trade until five minutes after the close by taking KT's 50,000 shares into Deutsche Bank's inventory at the closing price, $1.89. At 4:06 p.m., Zitman

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[10] Brokaw testified that he abruptly ended the conversation between Ewing and Zitman because he deemed it inappropriate that a sales assistant would be discussing a client's strategies, Zitman made simple things overly complicated, and Brokaw wanted Zitman to "get the order in."

[11] KT testified that his instructions to Brokaw were to execute this order "very close to the close."

confirmed selling the second 50,000-share lot at $1.89. Brokaw, who erroneously understood that the sale had been a market execution, responded: "You got that 50 done at 89 cents at the end of the, you must have been the last print there, huh? . . . You must have been like printing it at the very, very end of the day where it went out at 89, right? . . . Wow, wow, wow."

The VWAP of MGRM on May 22, 2006, was $1.96, with nearly 2.4 million shares traded that day. KT sold 305,000 shares representing approximately 13 percent of the trading volume.

F. KT's Trading on May 23, 2006

Before the market opened on May 23, 2006, Zitman called Brokaw's office to inquire about another order from KT and spoke with Brokaw's business partner, Mary Mayer ("Mayer"). At the same time, KT was on the phone with Brokaw's office. KT told Brokaw to sell 50,000 shares at the open and close like the two previous days. Mayer conferred with Brokaw and then told Zitman, "Same order as yesterday." Zitman confirmed, "He's giving me 50,000 more for sale?" and Mayer responded, "50,000 more for sale. . . . On the open." Deutsche Bank executed KT's order within the first minute of trading at an average price of $1.87. Zitman called Brokaw at 9:31 a.m. and reported the execution. Brokaw asked: "How did you do that so quickly?" When Zitman responded that he didn't know, Brokaw suggested: "They must be setting up on the other side. Okay, cool. . . . You did 50 on the open, then, you just like banged them." Brokaw told Zitman that he would have another order from KT to sell 50,000 at the close.

Brokaw and Zitman spoke that afternoon to confirm KT's order:

Brokaw: All right. So here's . . . what [KT] doesn't want on this. He said, look, I don't mind you guys printing me all on one—he said I kind of want it spread out a little bit.

Zitman: Well, then he's got to [expletive] give me until, I mean, you know. The [expletive] guy, he wants his cake and he wants to eat it too?

Brokaw: He wants to eat it too. Well, you know, exactly. So just take it with a minute to go and spread it out a little bit . . . . In other words, hit the, he wants to hit the bids like in a, in a—[12]

Zitman: What, he's trying to mark the close?[13]

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12 Zitman thought Brokaw's order instructions were unusual because it was not typical to spread out an order one minute prior to the close rather than over the course of a day.

13 "Marking the close" is defined as "the practice of repeatedly executing the last transaction of the day in a security in order to affect its closing price." *SEC v. Masri*, 523 F. Supp. 2d 361, 369 (S.D.N.Y. 2007) (internal quotation omitted). Brokaw testified that, at the time, he did not understand the definition of "marking the close" and when Zitman mentioned it, he thought Zitman meant that he would sell into the close. Brokaw was trying to communicate that KT did not care about the close but rather getting the order done in the last minute before the

[Footnote continued on next page]

Brokaw: Yeah.
Zitman: [H]e could [expletive] be going away for a long time doing that.
Brokaw: Really?
Zitman: Yeah. You can't mark the [expletive] close. It's [expletive] illegal.
Brokaw: Eh, I didn't think so.
Zitman: Yeah, [expletive] it, I no. I'm not marking the close for him.
Brokaw: No, no, no.
Zitman: I'm not giving up my [expletive] license.
Brokaw: No, no, no, me neither. No, just sell 50 on the close.
Zitman: That's a (inaudible) 50,000 market on close.

KT told Brokaw to execute the 50,000 share order near the close without a price limit and to make sure it "got done before the close." KT did not specifically recall telling Brokaw to spread out the trades but it made sense to him that he would have because he would get a better price. KT, however, was emphatic that he primarily wanted the shares sold and was less concerned with price. Brokaw interpreted KT's order instructions to him to mean KT wanted him to be less aggressive in selling toward the close and that KT did not want his order executed as rapidly as it had been that morning.[14]

Zitman entered the afternoon order into Deutsche Bank's electronic order system at 3:51 p.m., but the order was not executed until after the close at 4:11 p.m. The Firm filled KT's order by taking the Fund's 50,000 shares into inventory at $1.84, that day's closing price. At 4:12 p.m., Zitman called Brokaw's office and reported the sale. Several minutes later, Brokaw's partner Mayer called Zitman back and asked: "That trade wasn't printed after the close, was it?" Zitman told Mayer that it was "the last print." A few minutes later, Brokaw called Zitman and sought Zitman's assurance that KT's trade was in VWAP because "that's all [KT] wants to know" and asked him to have equity trader Messer let him know "whether we were in the VWAP with the 50."

KT became angry after learning that the Firm executed his afternoon order on May 23 by taking his shares into inventory. KT testified that he directed Brokaw to execute his order near, but before the close and the Firm acted contrary to his instructions. Brokaw spoke with Messer and William Matthews ("Matthews"), a senior trader on the Firm's equity desk, and expressed

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close. The Hearing Panel found that all of Brokaw's attempts to refute the plain meaning of the words on the tapes were unpersuasive and not credible.

[14] Brokaw testified that he tried to give accurate instructions to the trading desk especially when it came to KT's orders. KT was a demanding customer with a history of execution problems with the Firm. Brokaw stated that, in retrospect, his incomplete sentences and use of phrases like "get the order done but spread it out" and "hit the bids" made his instructions to the traders unclear.

that taking shares into inventory was not how KT wanted the order executed. Messer and Matthews did not understand what it was about the execution that KT was unhappy about when Messer had understood that KT wanted the stock sold at the close and he executed the order by paying the closing price for the stock. Brokaw further expressed his dissatisfaction with the execution to Zitman expressing that "[a]ll we're trying to do is print as much stock between . . . the last minute and the close. Whether we get the close or not, I don't really care, but what I did care about was that we printed as much stock as we could."[15]

Later that day, Zitman spoke with Messer and Matthews about KT's order and together they concluded that KT and Brokaw "were trying to potentially affect the VWAP so that the rights would be priced more favorably." The matter was immediately brought to the attention of Deutsche Bank compliance personnel, who determined that the Firm should stop executing KT's orders in MGRM.[16]

The VWAP of MGRM on May 23, 2006, was $1.91, with a trading volume of 1.8 million shares. KT sold 152,500 MGRM shares that day.

G. The VWAP of MGRM

At the conclusion of the pricing period, MGRM announced that the average VWAP for the pricing period was $1.85 and therefore CVR holders would receive the maximum payout of $0.88.[17] Following the pricing period, the Fund received a payment of more than $16.3 million for its CVRs. Brokaw and his family received approximately $190,000 for their CVRs.[18]

H. Order Tickets for KT's Six Sell Orders

The Firm's procedures required Brokaw to create an order ticket "immediately upon receipt" of an order, but Brokaw did not do this. Brokaw testified that he played no role in the order ticket preparation process and that he delegated this responsibility to his sales assistants.

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[15] Brokaw and KT erroneously believed that 12,600 shares of the order were sold during the trading day and the remaining 37,400 shares were taken into the Firm's inventory after the close. The Firm, however, had taken the entire 50,000 share-lot into its inventory after the close. KT requested and received from the Firm cancellation of the 37,400 share sale that he believed was contrary to his order instructions to sell at the close.

[16] KT continued to sell MGRM shares through the pricing period at other broker-dealers without restriction.

[17] The VWAP remained below the $2.02 benchmark after the pricing period ended. The average VWAP in 30-, 60-, and 90-day intervals after June 12, 2006, was $1.82, $1.73, and $1.69 respectively.

[18] The CVR payouts listed here do not take into account the cost basis for the CVRs.

At the end of each of the three trading days, Brokaw's second sales assistant, Daniel Aliperti ("Aliperti"), prepared a "booking ticket" that combined KT's morning and afternoon sales and falsely indicated that KT placed the Fund's orders directly with a Deutsche Bank sales trader when, in reality, KT placed the orders directly with Brokaw.[19] Each day's booking ticket inaccurately reflected a single order for the sale of 100,000 shares at a single execution price with a single time stamp.

IV. Discussion

The central issue before us on appeal is whether KT's orders, that Brokaw executed, constituted a manipulation, and if so, whether Brokaw is responsible as a manipulator. After a thorough review of the record, we dismiss the Hearing Panel's findings that Brokaw engaged in a manipulation when he sold MGRM shares on KT's behalf.[20] We find instead that Brokaw failed in his ethical obligations to conduct an adequate inquiry into whether KT's trading instructions with respect to the MGRM stock sales were for a manipulative purpose. We further find that Brokaw caused his Firm's books and records to be inaccurate when he failed to ensure the accurate preparation of KT's order tickets. We discuss the violations in detail below.

A. Alleged Open-Market Manipulation Involving MGRM Stock Sales

1. Legal Standard of Proof

Enforcement's complaint alleges that Brokaw's sell orders placed on KT's behalf near the open and close of the market operated as a manipulative and deceptive scheme in violation of the antifraud provisions of the Exchange Act, as well as SEC and NASD rules. Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rule 2120 prohibit fraudulent and deceptive acts and practices in connection with the offer, purchase, or sale of a security.[21]

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[19] Ewing testified that Deutsche Bank used a "booking ticket" when a client placed an order directly with a sales trader. A Firm branch would create a booking ticket after the order was executed to facilitate proper accounting of the trade.

[20] We also determine that a preponderance of the evidence does not support a finding that Brokaw aided and abetted a manipulation by KT. To find that Brokaw is liable as an aider and abettor, Enforcement was required to prove: (1) a primary securities law violation committed by another party or parties, here KT; (2) that Brokaw rendered substantial assistance in furtherance of the conduct constituting the violation; and (3) that Brokaw provided such assistance with scienter. *See Dep't of Mkt. Regulation v. Proudian*, Complaint No. CMS040165, 2008 FINRA Discip. LEXIS 21, at *22 (FINRA NAC Aug. 7, 2008). Because Enforcement did not prove that KT committed a securities violation, its aiding and abetting claim against Brokaw must fail.

[21] Exchange Act Section 10(b) makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). In addition to prohibiting nondisclosure and false and misleading statements,

[Footnote continued on next page]

Manipulation is "virtually a term of art when used in connection with securities markets." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). Manipulation "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Id.*; *Swartwood Hesse, Inc.*, 50 S.E.C. 1301, 1307 (1992) ("Manipulation is the creation of deceptive value or market activity for a security, accomplished by an intentional interference with the free forces of supply and demand."). Manipulative schemes are referred to as "open-market" manipulations when the alleged scheme is accomplished solely through the use of facially legitimate open-market transactions. Open-market transactions involve the transacting party purchasing or selling securities in the open market without any prior arrangement with the counterparty, unlike prohibited trading practices such as wash sales and matched orders, which are intended to mislead investors.[22] *Compare Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977) (explaining that manipulation refers to conduct intended to mislead investors "by artificially affecting market activity"), *and United States v. Mulheren*, 938 F.2d 364, 370 (2d. Cir. 1991) (discussing the absence of "traditional badges of manipulation" such as wash sales and matched orders), *with SEC v. Masri*, 523 F. Supp. 2d 361, 367 (S.D.N.Y 2007) (explaining that the activity in "open-market" cases is not expressly prohibited). A broker "can be primarily liable under Section 10(b) for following a [principal's] directions to execute stock trades that [he] knew, or was reckless in not knowing, were manipulative, even if [he] did not share the [principal's] specific overall purpose to manipulate the market for that stock." *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 108 (2d Cir. 1998) (vacating an order granting a broker's motion to dismiss for failure to state a claim and remanding for further proceedings where a broker was alleged to have "knowingly or recklessly participated in and furthered a market manipulation by . . . effecting wash sales and matched orders" and "intentionally engaged" in "manipulative conduct") (internal quotations omitted).

The Commission has explained that "[p]roof of a manipulation almost always depends on inferences drawn from a mass of factual detail" including "patterns of behavior[ ] and . . . trading data." *Kirlin Sec., Inc.*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *44-45 (Dec. 10, 2009) (internal quotations omitted). In making a determination of whether a manipulation occurred, the Commission has observed that such schemes often display several common characteristics including a rapid surge in the price of a security, little investor interest in the

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Exchange Act Rule 10b-5 prohibits "any device, scheme, or artifice to defraud" or any conduct "which operates or would operate as a fraud or deceit upon any person." NASD Rule 2120 is FINRA's antifraud rule and is similar to Exchange Act Section 10(b) and Rule 10b-5. *Mkt. Regulation Comm. v. Shaughnessy*, Complaint No. CMS950087, 1997 NASD Discip. LEXIS 46, at *24 (NASD NBCC June 5, 1997), *aff'd*, 53 S.E.C. 692 (1998).

[22] "Wash sales" are transactions with no change in beneficial ownership. *Ernst & Ernst*, 425 U.S. at 206 n.25. "Matched orders" are purchases or sales of a security that are entered knowing that orders for the sale or purchase of substantially the same amount of stock have been or will be entered by the same or different persons at substantially the same time and price. *Id.*

security, the absence of any known prospects for the issuer or favorable developments affecting the issuer or its business, and market domination. *Id.* at *45. In *Kirlin*, the Commission reaffirmed its long-standing use of the "sole purpose" of the manipulator test, which the D.C. Circuit most recently upheld in *Markowski v. SEC*, 274 F.3d 525 (D.C. Cir. 2001).[23] *See Kirlin*, 2009 SEC LEXIS 4168, at *57-58. As early as 1949, the Commission found manipulation based on the purpose behind the actions of a market participant. *Halsey, Stuart & Co.*, 30 S.E.C. 106, 124 (1949) ("Hope, belief and motive are not *purpose* . . . [b]ut *purpose* must be inferred when hope, belief, and motive are implemented by activity objectively resulting in market support, price raising, sales at higher prices and the protection of inventory."). In 1959, the Commission supported a finding of domination of the market based on an underwriter's bidding and trading activities that "were designed to stimulate buyer interest" and also to restrict artificially the floating supply of a stock. *See Gob Shops of Am., Inc.*, 39 S.E.C. 92, 101 (1959).[24]

Brokaw argues that certain federal appellate court precedent applies to the facts of this case and that against this legal backdrop, Enforcement failed to prove that Brokaw engaged in any act that constitutes a manipulation. *See, e.g., ATSI Commc'ns., Inc. v. The Shaar Fund*, 493 F.3d 87 (2d Cir. 2007) (requiring proof of deceptive device through "some market activity, such as wash sales, matched orders, or rigged prices"); *GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 204 (3d Cir. 2001) (requiring proof of some additional deceptive device used to inject inaccurate information into the marketplace). Our decisions, however, are appealed directly to the Commission and its holdings are binding on us. We determine that the Commission's decision in *Kirlin*, which postdates these federal appellate court cases, reaffirms its consistent use of the legal standard for proving manipulation and is controlling here.[25]

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[23] In *Markowski*, the firm manipulated the market through open-market transactions by dominating the aftermarket for the stock at issue, maintaining high bid prices for the securities, and absorbing all unwanted securities into inventory, thereby preventing sales from depressing market prices. 274 F.3d at 527. The D.C. Circuit, in affirming a market manipulation violation under Section 10(b), Rule 10b-5, and NASD rules, held it sufficient merely to prove a manipulative purpose behind a series of real transactions, regardless of the impact on the market. *Id.* at 529.

[24] *See also Universal Heritage Inv. Corp.*, 47 S.E.C. 839, 842 (1982) (finding a broker-dealer manipulated the market when the firm repeatedly increased its bids for a readily available security to create the false appearance of activity in the over-the-counter market and charge customers unfair prices); *Bruns, Nordeman & Co.*, 40 S.E.C. 652, 660 n.11 (1961) ("A person contemplating or making a distribution has an obvious incentive to artificially influence the market price of the securities in order to facilitate the distribution or to increase its profitability. We have accordingly held that where a person who has a substantial interest in the success of a distribution takes active steps to increase the price of the security, a prima facie case of manipulative purpose exists.").

[25] Although we recognize that the specific manipulative activity in *Kirlin* was different from the activity in this case, we find the Commission's legal standard directly applicable.

2. Failure of Proof

The issue here is whether KT's "open market" sales transactions qualify as a fraudulent scheme because Brokaw acted with manipulative intent.[26] *See Kirlin*, 2009 SEC LEXIS 4168, at *57 ("[T]he Commission has consistently held that an applicant's scienter renders his interference with the market illegal . . . ."). In other words, we must determine whether Brokaw executed KT's trades when Brokaw knew or was reckless in not knowing that they were for a manipulative purpose. *See U.S. Envtl.*, 155 F.3d at 111. We have considered the factual details here, and the possible inferences to be drawn from them, and find that Enforcement failed to prove that Brokaw engaged in a manipulation. *See, e.g., Brooklyn Capital & Sec. Trading, Inc.*, 52 S.E.C. 1286, 1290 (1997) ("In determining whether a manipulation has occurred, we have depended on inferences drawn from a mass of factual detail including patterns of behavior, apparent irregularities, and from trading data." (internal quotations omitted)).

In finding that Brokaw manipulated MGRM stock, the Hearing Panel determined that Brokaw placed the sell orders for KT near the open and the close of the market during the pricing period *solely* to artificially depress the price of MRGM shares and favorably impact the pricing of the CVRs, without a legitimate trading strategy. In making this finding, however, the Hearing Panel largely ignored and gave little weight to KT's testimony, which encompassed more than 250 pages of transcript. We find that the Hearing Panel erred. The Hearing Panel made no findings with respect to KT's overall credibility. We analyze KT's testimony because it is highly relevant to the issue of the purpose of his trades.

The evidence shows that KT offered a legitimate economic reason for his MGRM sales, and the trading instructions that he gave to Brokaw, and Enforcement failed to disprove this economic reason. KT believed the CVRs were undervalued relative to the price of MGRM stock and by owning both securities he could capture the inefficiencies. KT testified that he had a bearish view on MGRM stock, testimony which was consistent with his months of sales of MGRM shares leading up to the pricing period. In rejecting respondents' arguments in *Kirlin* that they placed trades for the investment purpose of acquiring and holding shares for one of the respondent's relatives, the Commission observed that the pattern of trading included the complete liquidation of shares and contradicted the purported investment purpose.[27] *Id.* at *57. Here, KT had been selling MGRM during the 18 months *prior* to the pricing period and his sales during the pricing period, while more aggressive in number, were consistent with his overall

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[26] Enforcement concedes that there is nothing illegal or improper about KT wanting his orders executed during the day in order to include them as part of the VWAP calculation during the pricing period.

[27] The Commission also found in *Kirlin* that respondents falsified documents in an effort to conceal trades and failed to provide best execution to a firm customer who placed a large order to liquidate shares, which threatened to depress the stock price. *Kirlin*, 2009 SEC LEXIS 4168, at *66-68, 73.

strategy with respect to MGRM shares.[28] *Compare Swartwood Hesse*, 50 S.E.C. at 1307 (finding "the pattern of [respondent's] trading contradicts his contention that his objective was merely the long-term accumulation of . . . stock" and rejecting respondent's argument that he did not engage in a manipulation).

KT had the "macro goal" of selling his nearly 3 million MGRM shares over the course of the 15 trading days during the pricing period and spreading out his sales as much as possible to receive "the most efficient execution."[29] KT determined to sell approximately 200,000-300,000 shares around the open and close of each day. KT testified that he learned from his prior trading, and through other brokers, that MGRM had the most liquidity in the beginning and end of each trading day. KT stated that he did not want an order filled throughout the day because, based on MGRM's trading history, he thought that the stock price would spike on the trading volume at the end of the day. Thus, it was KT's view based on his historical knowledge that it was advantageous to split orders at the open and close to be assured that the order was filled. He also understood that by selling into higher volume he would not affect the price as dramatically. In preparation for the hearing below, KT prepared a summary exhibit illustrating that his theory of MGRM's liquidity was borne out empirically. The Hearing Panel, however, determined that because KT prepared this exhibit after the fact, he could not have relied on this exhibit to inform his strategy and gave his testimony no weight.[30] A broker from another firm handling KT's

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[28] From December 28, 2004, to May 18, 2006, KT sold 5.4 million MGRM shares and bought 468,000 for net sales of more than 4.8 million. The Hearing Panel found relevant in discounting KT's testimony the fact that KT bought shares in the three weeks before the pricing period contrary to his purported selling strategy. The record shows, however, that KT bought many of these shares shortly after attending a Deutsche Bank healthcare conference in May 2006 where MGRM representatives made a presentation in advance of the company's news announcing its deal with Pfizer, whereafter the MGRM share price spiked. Moreover, KT testified that his purchases before the pricing period were in an effort to take advantage of "inefficiencies in the marketplace" and that "he is in the business of trying to project what is going to happen and profit from that projection." KT believed that the Pfizer deal would temporarily benefit MGRM's stock price but ultimately add a "lethal cost." We do not agree with the Hearing Panel that such purchases were entirely inconsistent with KT's overall "bearish" view of MGRM given these facts.

[29] KT stated that these shares represented less than a five percent ownership stake in MGRM.

[30] In reference to this same point, the Hearing Panel later stated that it found KT's claim "at the hearing that the large sales in the first and last minutes of trading [were] designed to get the best price, based upon KT's impression that prices were higher at the open and the close of the market," not credible. We find that the Hearing Panel mischaracterized KT's testimony, which was that KT sold near the open and close because he understood that historically the volume was highest during these times, which would assure him that his orders were filled. KT's testimony is emphatic that he primarily wanted the shares sold and was less concerned with price. Because the Hearing Panel's finding was factually inaccurate, we disregard its conclusion that KT's

[Footnote continued on next page]

orders testified that he agreed with KT's view and that KT was selling MGRM during the time of day when it was most liquid. KT's opinion of MGRM's liquidity is also not inconsistent with the general perception of market liquidity: "[S]tudies have shown that trading in organized securities is heaviest just before the market closes, as traders monitor activity and their positions throughout the day before conducting their trades." *Masri*, 523 F. Supp. 2d at 370 (*citing* Daniel R. Fischel & David J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 Harv. L. Rev. 503, 520 (1991)). We determine that the evidence shows that KT had a rational strategy, and the Hearing Panel's erroneous determination to ignore KT's testimony tips the balance of proof against Enforcement. "Where, as we find here, trading is motivated by a valid economic rationale and executed in a lawful manner, any effect (or avoidance of effect) on the market price of the stock as a result of such trading is not improper."[31] *Dep't of Mkt. Regulation v. Respondent*, Complaint No. CMS030257, slip op. at 8 (NASD NAC Oct. 12, 2005).

There also is no direct evidence that KT told Brokaw to drive down the price of MGRM's shares to influence the VWAP. To the contrary, KT testified that he had no objective to drive down the price of MGRM shares, but rather to "project what is going to happen and profit from that."[32] KT testified that there were times in the past when he traded and used the VWAP as a benchmark for determining appropriate executions, and generally when he sold stock, his execution prices were below the VWAP. KT stated that with respect to his MGRM sales, he was "not concerned about the VWAP" because the "stock was trading millions of shares a day" and he had a "negligible effect on the VWAP." The record reflects that KT sold approximately 3 million of the nearly 25 million MGRM shares that traded during the pricing period. Without more, we find that Enforcement failed to prove that KT's trades had a disproportionate effect on the final VWAP. The VWAP for each day of the pricing period constituted 1/15 of the final VWAP for determining the CVRs' value, regardless of the volume on a particular day or time of day.

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testimony on this point was not credible. Especially in light of the Hearing Panel's silence regarding KT's overall credibility, we find that the totality of the record evidence supports that the open and close of the market provided the highest trading volume.

[31] We do not draw an inference of manipulative intent from KT's orders being entered near the open and close of the market because the pricing of the MGRM CVRs was based on an equally weighted combination of the VWAP over the 15-day period. This is in contrast to situations in which marking the close is a manipulative act. *See, e.g., Thomas C. Kocherhans*, 52 S.E.C. 528, 530 (1995) ("We have previously made clear that the practice of placing orders at the end of the day to cause a stock to close higher constitutes a manipulative practice.").

[32] Brokaw also denied that he ever attempted to manipulate MGRM stock, which the Hearing Panel found not credible.

The language on the tapes reveals that Brokaw should not have closed his eyes to the trading atmosphere surrounding MGRM and KT's orders. When we consider all of the facts before us, however, we conclude that Enforcement has not proven that Brokaw knew or was reckless in not knowing that following KT's directions was manipulative. Brokaw had no discretion over KT's orders—all of which were unsolicited orders. Rather, Brokaw worked these orders through the Firm's trading desk, which executed them at prevailing market prices. These facts militate against a finding that he was involved in any manipulative scheme.[33] *Compare Masri*, 523 F. Supp. 2d at 375 (declining to hold broker responsible for market manipulation after following principal's orders to execute a sizable order in a thinly traded stock at the end of a trading day), *with Kirlin*, 2009 SEC LEXIS 4168, at *52, 59 (finding firm's head trader, who entered or reviewed the majority of manipulative trades on behalf of the firm's CEO, liable for manipulation). The record further shows that while Brokaw knew KT's general strategy with respect to selling MGRM shares during the pricing period, KT had no prior selling arrangement with Brokaw and Brokaw did not know whether he would receive any orders from KT until each day in question. KT testified that he shared with Brokaw his "bearish" view on MGRM, the mechanics of how the CVRs worked, the concept of a hedged position, and his general trading strategy that he wanted to own more CVRs than stock at the conclusion of the pricing period, but he never informed Brokaw of the number of MGRM shares that he had to sell during the pricing period, the pace at which he planned to sell those shares, or the other broker-dealers that he was using also to sell MGRM shares.[34]

We find that Brokaw sold shares without discretion at the beginning and end of three trading days after being directed to do so by KT and that Enforcement set forth insufficient evidence proving that the transactions were manipulative. "[F]luctuations in the market price of stock resulting from legitimate trading activities is a natural and lawful result of such activities." *In re Olympia Brewing Co. Sec. Litig.*, 613 F. Supp. 1286, 1292 (N.D. Ill. 1985). We determine that, under the facts of this case, Enforcement did not prove by a preponderance of the evidence that Brokaw intended to manipulate MGRM shares and dismiss cause one of the complaint.

B. NASD Rule 2110 Violation

Enforcement alleged in cause two of its complaint that Brokaw acted unethically, and in violation of NASD Rule 2110, when he failed to inquire diligently into KT's trading instructions to ensure that the trades were not for a manipulative purpose. While we determine that Enforcement failed to prove that Brokaw's trading on KT's behalf rose to the level of manipulation, that determination does not exonerate Brokaw from liability under NASD Rule 2110. *See, e.g., Dante J. DiFrancesco*, Exchange Act Rel. No. 66113, 2012 SEC LEXIS 54, at *18 (Jan. 6, 2012) (discussing NASD Rule 2110 and stating that "proving motive or scienter is

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[33] For example, with respect to the morning order on May 22, Brokaw clarified to the Firm's trader that the order was a market order.

[34] Brokaw testified that KT told him about his MGRM sales through another broker-dealer after the market closed on May 23, 2006, when KT complained about his shares being taken into the Deutsche Bank's inventory.

not required, and a showing of unethical conduct, even if not in bad faith, can be sufficient to establish liability" (internal citations omitted)); *Calvin David Fox*, 56 S.E.C. 1371, 1376 (2003) ("With respect to a charge that conduct was inconsistent with just and equitable principles of trade, we have held that a self-regulatory organization need not find that the respondent acted with scienter, but must find that the respondent acted in bad faith or unethically."). NASD Rule 2110 is a broad ethical concept that covers all unethical business-related conduct. *Dep't of Enforcement v. Shvarts*, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11 (NASD NAC June 2, 2000). As we have stated, "one may find a violation of the ethical requirements where no legally cognizable wrong occurred." *Id.*

In analyzing whether a registered representative's conduct violates NASD Rule 2110, the SEC has "focused on whether the conduct implicates a generally recognized duty owed to clients or the firm." *DiFrancesco*, 2012 SEC LEXIS 54, at *19. The SEC has explained that a broker has a duty to make a diligent inquiry when confronted with suspicious circumstances surrounding trading activity or faces violating NASD Rule 2110. *See Robert J. Prager*, Exchange Act Rel. No. 51974, 2005 SEC LEXIS 1558, at *31 (July 6, 2005). "The importance of a broker-dealer's responsibility to use diligence where there are any unusual factors is highlighted by the fact that violations of the anti-fraud and other provisions of the securities laws frequently depend for their consummation . . . on the activities of broker-dealers who fail to make diligent inquiry to obtain sufficient information to justify their activity in the security." *Alessandrini & Co.*, 45 S.E.C. 399, 406 (1973). Brokaw testified that he agrees that a broker has a duty to be "diligent and vigilant on activities that are suspicious," but that he saw nothing wrong with taking in market orders at the beginning and end of the day for KT. Brokaw, however, disavowed any responsibility for determining whether KT's trading instructions were suspicious and testified that he believed that the Firm's traders were the parties tasked with clarifying any issues with KT's orders and alerting Brokaw if there was something suspicious about the trades. We find that the confluence of factors found in this case should have provided Brokaw with notice that further inquiry on his part was required, and he had a duty not to proceed with KT's trades until he determined whether KT's trading instructions were for a prohibited purpose.

Brokaw was familiar with the CVRs and the pricing period because he personally owned CVRs. In light of his knowledge, the timing and size of KT's orders was sufficiently suspicious to put Brokaw on notice that he might be participating in a market manipulation scheme. *See, e.g., In re Amaranth Natural Gas Commodities Litig.*, 587 F. Supp. 2d 513, 535 (S.D.N.Y. 2008) ("While the sale of a large number of futures is not inherently manipulative, allegations that a defendant repeatedly sold large numbers of futures just before the close of settlement periods are sufficient to allege commodities manipulation."); *Masri*, 523 F. Supp. 2d at 370 (stating that timing of transactions provides "some limited evidence of manipulative intent"). Prior to the pricing period, it had been more than six months since KT placed an MGRM order with Brokaw. As evidenced by his conversation with Watson, Brokaw knew that KT's orders were taking place during the pricing period, that KT owned "a ton" of the CVRs, and that KT wanted to be "net short" the stock by the end of the pricing period. Despite explaining in some detail to Watson the likelihood of selling pressure given the pricing period and the CVR valuation process, Brokaw failed to question KT when receiving orders to sell 50,000 MGRM shares at the open and end-of-day on consecutive trading days after not having received an MGRM order from KT

since October 2005 when KT sold 11,500 shares. Moreover, Brokaw testified that he understood that KT was not price sensitive and wanted quick execution, but KT never explained his rationale to him for placing the trades at the open and the close and there is no evidence that Brokaw was aware of KT's belief that the volume of MGRM was greatest at the open and close. KT also departed from his past practices on multiple fronts. On the morning of May 19, 2006, KT previewed to Brokaw that he would be coming back in the afternoon with another order, which was something he had never done before with Brokaw. In addition, the size of the orders at 50,000 shares each was significantly larger than the orders that KT usually placed with Brokaw. Brokaw, however, dismissed the size of the orders based on the fact that he knew KT was unwinding a position in the MGRM common stock. Brokaw should not have viewed this fact in isolation.

We find significant that Brokaw failed to question KT about his trading instructions on May 23, 2006, after having received the directive to sell MGRM shares aggressively at the open and close for the third consecutive trading day. Brokaw testified that never, until receiving KT's orders, had one of his customers "come in in the morning and the night . . . simultaneously." In an effort to demonstrate that he acted properly, Brokaw relies on the fact that the Firm did not indicate to him that there was a problem with KT's orders until after the close on May 23 and then refused to accept further MGRM orders from KT, beginning on May 24. Brokaw cannot blame others for what was his responsibility as the gatekeeper when he received KT's instructions. *See Alessandrini*, 45 S.E.C. at 406. Brokaw's duty to act as an unconflicted gatekeeper was further heightened by the fact that he himself held CVRs. Brokaw should have recognized that KT's trading pattern could be indicative of marking the open and close or otherwise manipulative trading and conducted a searching inquiry into those trades or inquired of others in a supervisory or compliance capacity at the Firm to determine whether he should be placing these trades. *See, e.g., Peter Martin Toczek*, 51 S.E.C. 781, 788 (1993) (finding that by broker entering orders at or near the close of trading on consecutive days, broker improperly influenced prices and engaged in conduct inconsistent with just and equitable principles of trade). He did not. Brokaw without hesitation communicated KT's requests and failed to heed warnings with respect to these trades.[35] Brokaw conceded at the hearing that despite this being the first time in his career that he received a series of orders like KT's, at the open and close, that he "probably would have" executed the same orders for KT on May 24 if the Firm had not intervened. Brokaw was confronted with warning signs that should have aroused his suspicions and caused him to question KT's trading and his own involvement in it. Accordingly, we conclude that Brokaw breached his ethical duty under NASD Rule 2110 to conduct a diligent inquiry into KT's orders to ensure they were not for a manipulative purpose.

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[35] Brokaw also failed to understand the significance of the trepidations of one of the Firm's traders. On the morning of May 22, 2006, Zitman called Brokaw to clarify KT's trading instructions that he received from Ewing in an effort to explain to Brokaw that a large market order, such as KT's, executed at the open could cause MGRM's share price to move drastically.

C. Inaccurate Order Tickets

The Hearing Panel found that Brokaw failed to ensure the accurate preparation of order tickets reflecting KT's sales of MGRM on May 19, 22, and 23, 2006, thereby causing his Firm's books and records to be inaccurate, in violation of NASD Rules 3110 and 2110.[36] We affirm these findings.

NASD Rule 3110 requires member firms to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by SEC Rule 17a-3. The record keeping format, medium, and retention period shall comply with Rule 17a-4. . . ."[37] In turn, Rules 17a-3 and 17a-4 require member firms to make and keep current certain books and records relating to their business activities, including directing broker-dealers to create and keep memoranda of all brokerage orders, and any instructions given or received for the purchase or sale of securities.[38] *See* 17 C.F.R. § 240.17a-3(a)(6)(i), § 240.17a-4(b)(1).

In 2006, Deutsche Bank required that a representative accepting a customer order initiate an order ticket "immediately upon receipt of an order." Brokaw, however, prepared no order tickets when he received KT's orders. Instead, Brokaw's assistant, Aliperti, completed booking tickets at the end of each trading day that combined each day's morning and afternoon orders and inaccurately reflected that KT placed his orders directly with sales traders Watson and Zitman

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[36] NASD Rule 0115 makes all NASD rules, including NASD Rule 2110, applicable both to FINRA members and all persons associated with FINRA members.

[37] Causing a member firm to enter false information in its books or records in violation of NASD Rule 3110 also violates NASD Rule 2110's requirement that members observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business. *See Dep't of Enforcement v. Trevisan*, Complaint No. E9B2003026301, 2008 FINRA Discip. LEXIS 12, at *27 (FINRA NAC Apr. 30, 2008).

[38] Exchange Act Rule 17a-3(6) specifically provides in relevant part that firms shall make and keep current

> [a] memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. The memorandum shall show the terms and conditions of the order or instructions and of any modification or cancellation thereof; the account for which entered; the time the order was received; the time of entry; the price at which executed; the identity of each associated person, if any, responsible for the account; the identity of any other person who entered or accepted the order on behalf of the customer or, if a customer entered the order on an electronic system, a notation of that entry; and, to the extent feasible, the time of execution or cancellation.

rather than through Brokaw. The booking tickets therefore did not reflect the separate orders of 50,000 shares each that KT placed with Brokaw at the open and close of each of the three trading days.

Brokaw testified that his "job was not to look at order tickets and review order tickets." Rather, he claimed "[t]hat was the function of my sales assistants," and he disclaimed responsibility for the failure to complete the required order tickets. Neither Ewing nor Aliperti completed an order ticket on Brokaw's behalf. Brokaw concedes that an order ticket "should have been generated," but he contends that he should not be held accountable for the order tickets when the Firm never previously complained about his practice of having his assistants complete the tickets. Brokaw misunderstands his responsibility as the representative on the account. Brokaw's branch manager James Knight testified that it was permissible for Brokaw to direct his sales assistant to complete the order ticket, but Brokaw was ultimately responsible to ensure that the ticket was completed accurately. Because Brokaw did not, and booking tickets rather than order tickets were created, he caused his Firm's records to be inaccurate in violation of NASD Rules 3110 and 2110. *See Dep't of Enforcement v. Wilson*, Complaint No. 2007009403801, 2011 FINRA Discip. LEXIS ___ (FINRA NAC Dec. 28, 2011), *available at* http://www.finra.org/web/groups/industry/documents/nacdecisions/p125348.pdf; *see also Fox & Co. Inv., Inc.*, Exchange Act Rel. No. 52697, 2005 SEC LEXIS 2822, at *30-32 (Oct. 28, 2005) (finding that entering incorrect information in documents constitutes a violation of NASD Rules 3110 and 2110).

D. Procedural Issue

Brokaw argues that the Hearing Panel's decision is "legally defective" because the Hearing Panel did not issue its decision within 60 days of the Hearing Officer's deadline for post-hearing briefs. Brokaw misunderstands the relevant NASD rule. Rule 9268 directs that the Hearing Officer "prepare" a written decision "[w]ithin 60 days after the final date allowed for filing proposed findings of fact, conclusions of law, and post-hearing briefs, or by a date established at the discretion of the Chief Hearing Officer." As the plain language reflects, the rule does not require that the Hearing Panel *issue* its decision within sixty days. *See Morton B. Erenstein*, Exchange Act Rel. No. 56768, 2007 SEC LEXIS 2596, at *24 (Nov. 8, 2007) ("Rule 9268 addresses the timing of the Hearing Officer's preparation of a decision (which must then be distributed to other members of the Hearing Panel), and not the issuance of the decision." (internal quotations omitted)). The record is devoid of evidence that would show that the Hearing Officer failed to prepare the decision within the requisite time. We accordingly reject Brokaw's argument.

V. Sanctions

The Hearing Panel barred Brokaw for manipulating MGRM stock and, in light of the bar, imposed no sanction for the books and records violation. Because we dismiss the manipulation findings, we also eliminate the bar imposed below. For Brokaw's failure to conduct an adequate inquiry to ensure KT's trading instructions were not for a manipulative purpose, we suspend Brokaw for one year and fine him $25,000. We also impose a 30-business-day suspension and $5,000 fine for causing Deutsche Bank's inaccurate books and records.

A. Inadequate Inquiry in Violation of NASD Rule 2110

Because there are no specific FINRA Sanction Guidelines ("Guidelines") for failing to conduct an adequate inquiry into trading instructions, we rely on the "General Principles Applicable to All Sanctions Determinations" and the "Principal Considerations in Determining Sanctions," which we apply in every disciplinary case to assist in our formulation of sanctions.[39] We find that several of these considerations apply to Brokaw's misconduct and serve to aggravate sanctions. At the time of the misconduct, Brokaw had been a member of the securities industry for more than 23 years and should have understood his obligation to act as an impartial gatekeeper here. Instead, Brokaw was indifferent to the ample warning signs that KT's trades could have been for an illicit purpose.[40] *Compare Kane v. SEC*, 842 F.2d 194, 200 (8th Cir. 1988) (affirming violations and sanctions in Section 5 of Securities Act of 1933 case and explaining that "willfulness" can be found if "a broker or dealer who is aware of several facts suggesting a suspicious transaction proceeds to facilitate the sale with reckless indifference to such facts, and ignores the obvious need for further inquiry and the duty to disclose all relevant information to his superiors"). As we discussed, the timing of KT's orders was suspicious, KT never before previewed his orders to Brokaw, and KT was the first of Brokaw's customers to simultaneously trade a stock at the open and close. Moreover, Brokaw indicated that he would have continued to place KT's orders had the Firm permitted him to do so. The six orders were also significant in size and notably larger than the orders KT usually placed with Brokaw.[41] We also find aggravating that Brokaw earned approximately $725 in commissions on the sales.[42] We also recognize that Brokaw also stood to profit from the value of his CVRs at the conclusion of the pricing period, which clouded his ability to conduct a discerning inquiry into KT's trades.[43]

We conclude that Brokaw's actions in this case were not otherwise reflective of his unblemished 23-year career in the securities industry. Under the circumstances and weighing the aggravating factors present here, we conclude that a one-year suspension and $25,000 fine is sufficient to remediate Brokaw's misconduct.

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39 *FINRA Sanction Guidelines* 2-7 (2011), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*].

40 *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

41 *See id.* (Principal Considerations in Determining Sanctions, No. 18).

42 *See id.* (Principal Considerations in Determining Sanctions, No. 17).

43 *See id.*

B. Books and Records Violations

For recordkeeping violations, the Guidelines recommend imposing a fine of $1,000 to $10,000, suspending the firm for up to 30 business days, and suspending the responsible individual for up to 30 business days.[44] In egregious cases, the Guidelines recommend imposing a fine of $10,000 to $100,000, and a lengthier suspension (up to two years) or barring the responsible individual.[45] We find that Brokaw's misconduct was serious, but not egregious. The Guidelines instruct adjudicators to consider the nature and materiality of inaccurate or missing information.[46] The missing order tickets are an important record in the securities industry, and this importance serves to aggravate Brokaw's misconduct. *See Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979); *see also Richard G. Strauss*, 50 S.E.C. 1316, 1317 n.5 (1992) ("Order tickets play an important role in the recording and settlement of a brokerage firm's transactions."). They are essential documents for record-keeping purposes because they permit member firms and regulators to review market activity in order to protect investors. We acknowledge that the Firm's transaction history report accurately reflected the type of order, the executing trader's name, the placement of each order, the executions in partial fills, the prices, and the times of the orders and fills. That fact, however, does not alleviate the requirement to complete order tickets at the time an order is received. Moreover, the use of a booking ticket rather than an order ticket would have misled the Firm's supervisory staff to believe that KT's orders were placed directly with a trader rather than Brokaw. The Firm's administrative branch manager and compliance officer Zbynek Kozelsky ("Kozelsky") testified that the Firm utilized order tickets in its surveillance functions and to facilitate the proper billing and posting of the orders to a customer's account. Brokaw's failure to ensure that order tickets were created when he received KT's orders undermined the accuracy of Deutsche Bank's records and circumvented an important Firm surveillance tool. *See Mawod*, 46 S.E.C. at 873 n.39 (recordkeeping rules are the "keystone of the surveillance of brokers and dealers"). It also serves to aggravate sanctions that Brokaw's failure was not an isolated incident. Brokaw received six orders from KT for which he completed no order tickets.[47] Brokaw also earned commissions on these trades.[48]

We also find aggravating that Brokaw blames others, including his sales assistants and Kozelsky, for his own failure to ensure the completion of order tickets.[49] Before the Hearing

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44 *Id.* at 29.

45 *Id.*

46 *Id.*

47 *See Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 18).

48 *See id.* (Principal Considerations in Determining Sanctions, No. 17).

49 *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 2).

Panel below, Brokaw asserted that Kozelsky enforced a practice of preparing booking tickets instead of order tickets and indicating falsely that orders were placed with sales traders even when this was not the case. The Hearing Panel discounted Brokaw's assertion and found that Kozelsky testified credibly that Brokaw was required to ensure completion of an order ticket when Brokaw received KT's orders. The substantial evidence necessary to reverse the Hearing Panel's findings of credibility on this point is absent; we thus agree with the Hearing Panel's determination. *See Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *17-18 (Feb. 10, 2004) (stressing that deference is given to initial decision maker's credibility determination "based on hearing the witnesses' testimony and observing their demeanor"). Brokaw's lack of candor in an effort to minimize his own responsibility is troubling. *See Dep't of Enforcement v. Frankfort*, Complaint No. C02040032, 2007 NASD Discip. LEXIS 16, at *41 (NASD NAC May 24, 2007) ("Providing inaccurate information in an effort to minimize one's own responsibility serves to aggravate sanctions.").

For causing Deutsche Bank's inaccurate books and records, we suspend Brokaw for 30 business days and fine him $5,000.

VI. Conclusion

We determine that Brokaw failed to conduct an adequate inquiry to ensure that a customer's trading instructions were not for a manipulative purpose, in violation of NASD Rule 2110, and caused his Firm's inaccurate books and records, in violation of NASD Rules 3110 and 2110. Accordingly, we suspend Brokaw for one year in all capacities and fine him $25,000 for his failure to conduct an adequate inquiry into his customer's trading instructions. We also fine him an additional $5,000 and concurrently suspend him for 30 business days for causing his Firm's books and records to be inaccurate. We affirm the order of hearing costs in the amount of $13,207.85.[50]

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith

Marcia E. Asquith
Senior Vice President and Corporate Secretary

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[50] We also have considered and reject without discussion all other arguments of the parties.

Pursuant to FINRA Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.