FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. STEPHEN BROWN (CRD No. 1799847), and JAMES GOETZ (CRD No. 2826111), Respondents.	Disciplinary Proceeding No. 2014042690502 Hearing Officer–CC **AMENDED EXTENDED HEARING PANEL DECISION** Date: August 2, 2017

Brown invested in securities away from the firm without providing the firm with accurate information about his investments. In some instances, Brown failed to update his prior written disclosures to maintain accuracy. Brown also engaged in outside business activities without providing accurate and timely notice to the firm and misrepresented to the firm facts regarding his business activities. For these violations, Brown is suspended for nine months and fined $125,000. Goetz executed five private securities transactions away from the firm without providing prior written notice and receiving prior approval. For this misconduct, Goetz is suspended for one month and fined $25,000.

Appearances

For the Complainant: Edwin Aradi, Esq., and Min Choi, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondent: Thomas B. Lewis, Esq., and Jonathan A. Scobie, Esq., Stevens & Lee.

DECISION

I. Introduction

This case involves Respondents' investments and business dealings away from their firm. Specifically, Stephen Brown ("Brown") disclosed, as passive outside investments, business dealings he also should have disclosed as outside business activities, and he failed to disclose that firm customers were involved or had invested in these outside businesses. James Goetz ("Goetz") invested in five private companies away from the firm without giving the firm prior written notice and receiving prior approval. Respondents do not materially dispute the factual allegations. The parties disagree, however, on the significance of Respondents' misconduct and the attendant aggravating and mitigating factors.

II. Procedural History

FINRA's Department of Enforcement ("Enforcement") filed the seven-cause Complaint on April 21, 2016. Causes one through six relate to Brown's private investments, outside business activities, and misrepresentations to his firm related to those investments and activities, as well as allegations that he attempted to circumvent his firm's compliance system. Cause seven relates to Goetz's investments away from his firm in five private companies.

Cause one alleges that Brown violated FINRA Rule 2010 by providing false responses to his employer, member firm Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"). Cause one alleges that Brown failed to state in compliance disclosures and in response to inquiries from the firm's compliance personnel the full scope of his participation in private investments and that firm customers also had invested in, or were principals of, these companies. Cause two alleges that Brown violated Rule 2010 by continuing the same omissions and misrepresentations alleged in cause one during Merrill Lynch's internal investigations. Causes one and two involve the same nine private investments addressed in causes three through five.

Cause three alleges that Brown violated FINRA Rule 2010 and NASD Rule 3040. Brown disclosed to Merrill Lynch his formation of Lorax LLC ("Lorax") as an investment vehicle for Brown and his family members to pool their funds to invest in one private company, Climax Global Energy ("Climax Global"). Merrill Lynch approved this as a private securities transaction based on Brown's disclosure. Cause three alleges that, subsequent to the disclosure, Brown participated in and facilitated a material expansion of Lorax such that Lorax gained additional non-family member investors and invested in three additional private companies. Cause three alleges that Brown never amended his disclosure to provide Merrill Lynch with prior written notice and he did not receive prior approval of the expanded Lorax operation. Cause four alleges that because Brown actively engaged in the business of managing Lorax by handling its finances, facilitating its investments, reporting to its investors, and making distributions, he should have disclosed Lorax as an outside business activity as well as a private securities transaction. Cause four alleges that, by failing to do so, Brown violated FINRA Rules 3270 and 2010 and NASD Rule 3030.

Brown disclosed his participation in the formation of a smoked whiskey distillery, Iron Smoke Whiskey LLC ("Iron Smoke"), as a private securities transaction. Merrill Lynch approved it as a passive investment not involving firm customers. Cause five alleges that Brown handled Iron Smoke's finances and held voting rights, and Brown therefore violated FINRA Rules 3270 and 2010 by failing to disclose Iron Smoke as an outside business activity involving firm customers.

Cause six alleges that Brown violated FINRA Rule 2010 by directing client associate AS to alter the name of the payee on a check drawn on a customer's account in order to circumvent Merrill Lynch's Office of Foreign Asset Control ("OFAC") compliance system.

Cause seven alleges that Goetz violated NASD Rule 3040 and FINRA Rule 2010 by investing in four private companies without giving prior written notice to, or receiving prior permission from, Merrill Lynch. Cause seven also alleges that Goetz sought permission to invest in a fifth company, Iron Smoke, was expressly told he was not authorized to invest, and invested anyway.

Respondents admit they failed to timely update their outside disclosures. Respondents deny that their misconduct is part of an ongoing and deliberate attempt to conceal outside businesses and investments from Merrill Lynch, as Enforcement alleges. Brown denies that he advised or instructed customer associate AS to circumvent Merrill Lynch's OFAC system.

The parties participated in a five-day hearing in January 2017.

III. Facts

A. Respondents' Background

Brown entered the securities industry in December 1987.[1] He was associated with Merrill Lynch from September 1991 through September 2014.[2] Goetz entered the industry in February 1998 and was associated with Merrill Lynch through September 2014.[3] The alleged misconduct occurred while Brown and Goetz were associated with Merrill Lynch. Brown and Goetz have been associated with another broker dealer since leaving Merrill Lynch.[4]

Brown was a top producer at Merrill Lynch and the firm's second-largest producer in upstate New York.[5] Brown and Goetz worked out of Merrill Lynch's offices in Rochester, New York. Brown served on several prestigious groups and committees within Merrill Lynch.[6] Their

[1] Complainant's Exhibit ("CX")-1, at 9.

[2] CX-1, at 9.

[3] CX-2, at 8, 11.

[4] CX-1, at 3; CX-2, at 8.

[5] Hearing Transcript ("Tr.") 417.

[6] Tr. 418-19.

working group, "The Brown Group," included two financial advisors (Brown and Goetz), several client associates, and administrative staff, and was part of Merrill Lynch's Private Banking Investment Group ("P-BIG").[7] P-BIG included approximately 350 Merrill Lynch financial advisors who serviced the firm's ultra-high net worth clients.[8] Members of P-BIG were limited to 50 client relationships (each relationship may hold any number of accounts) and each client had to have assets of at least $2.5 million invested with Merrill Lynch.[9]

The P-BIG "hub" office that oversaw the Brown Group was the P-BIG Boston office of Merrill Lynch.[10] Brown and Goetz managed more than $3 billion, approximately 92 client relationships, and 2,500 customer accounts between them.[11] Approximately 60 percent of the Brown Group's business was made up of ultra-high net worth individuals and approximately 40 percent was made up of institutions, mainly retirement plans or stock option plans.[12] Financial advisors who were part of P-BIG could service customers who held less than $2.5 million in assets with the firm, but they would not receive compensation for their work in those accounts, and those accounts did not count towards the financial advisor's limit of 50 customer relationships.[13]

Brown built the Brown Group's business through community involvement in Rochester. Brown attributed his business success, in part, to his involvement in local philanthropy and service on philanthropic boards.[14] He also credited much of the growth of the Brown Group's business to the success of local businessman AC, who was Brown's client and in whose ventures Brown invested.[15] Many of Brown's clients knew each other through the Rochester business community, and many invested in AC's business ventures through their own connections to AC.[16]

The Brown Group focused extensively on providing its high-end clients with superior customer service. Brown's immediate supervisor, Rochester administrative manager William Page ("Page"), testified that Brown's clients never left him and that he "took really good care" of

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[7] Tr. 686.

[8] Tr. 1008-09.

[9] Tr. 687-88.

[10] Tr. 708.

[11] Tr. 1422, 1531.

[12] Tr. 689.

[13] Tr. 688. Brown testified that he handled several accounts for individuals, mainly friends, who did not meet the P-BIG asset threshold. Tr. 782.

[14] Tr. 750.

[15] Tr. 751.

[16] Tr. 751-52.

his clients.[17] Page testified that, at times, Brown would "push back" on compliance issues, but always for the benefit of his clients.[18]

B. Supervisory Structure at Merrill Lynch

Merrill Lynch's supervisory structure is somewhat unclear with respect to oversight of the Brown Group. Although supervision is not an issue in this case, we heard testimony from Merrill Lynch's Rochester management team and its P-BIG management team in Boston.[19] Page and Rochester administrative manager Roberta Wagner ("Wagner") shared responsibility for compliance in Rochester.[20] They reported to Jeffrey Adams ("Adams"), the director of the Rochester office.[21] Brown, Page, Wagner, and Adams testified that the P-BIG managers in the P-BIG Boston office also provided oversight of the Brown Group.[22] Brown testified that during his 20-plus-year tenure at Merrill Lynch, he cycled through somewhere between nine and twelve different local managers and, as a result, came to rely much more heavily on P-BIG management in Boston.[23] The Boston P-BIG managers, regional managing director Gregory McGauley ("McGauley") and Boston administrative manager Paul Bowes ("Bowes"), disagreed. McGauley testified that he and Bowes had supervisory responsibility only for the P-BIG hub office in Boston, and their responsibility for individuals in the northeast P-BIG region, which includes Rochester P-BIG, was to provide leadership, not supervision.[24]

C. Merrill Lynch's Policies and Procedures Related to Outside Business Activities and Private Securities Transactions

Merrill Lynch's policies required financial advisors who sought to engage in outside business activities or invest away from the firm to provide the firm with prior written notice and receive prior approval.[25] The firm prohibited financial advisors from investing jointly with their

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[17] Tr. 421.

[18] Tr. 420.

[19] Tr. 877-80.

[20] Tr. 263-64, 1174-76.

[21] Tr. 262, 1174-75.

[22] Tr. 527, 804-05, 872-74, 879-81, 1198-99. Adams testified that he and Page oversaw compliance for the Brown Group, with assistance from the Boston P-BIG managers for "anything that they were not sure about that might pertain to ultra-high net worth clients." Tr. 873-74. Adams stated that, because of the Brown Group's dual reporting structure, he also reached out to Boston P-BIG management for some operational issues. Tr. 880-81.

[23] Tr. 1410-11. Brown Group client associate AS testified that the Brown Group relied more heavily on P-BIG Boston management than on the local Rochester management team. Tr. 251. AS testified that she was told repeatedly that the Brown Group reported to P-BIG in Boston. Tr. 220, 240-41, 246, 251.

[24] Tr. 1090-92. However, McGauley, not Page or Adams, was involved in the internal investigative interviews that ultimately led to Merrill Lynch's termination of Brown and Goetz. Tr. 1114-15.

[25] CX-66.

clients or in a client's business.[26] Exceptions to these policies required prior approval by senior management in consultation with the firm's compliance department.[27] Merrill Lynch required its financial advisors to certify annually that they were familiar with the policies in Merrill Lynch's 850-page policies and procedures manual.[28] Between 2008 and 2011, Brown requested and was denied permission to invest in various private companies because of customer involvement.[29] During this period, he also received some exceptions to the prohibition and was allowed to invest alongside customers.[30]

Merrill Lynch financial advisors reported outside business and private securities transactions in an on-line system known as the Associate Investment Monitoring ("AIM") system.[31] Page and Wagner conducted an initial review for completeness of Goetz's and Brown's disclosures in AIM and then passed the disclosures on to the firm's Centralized Business Review Unit ("CBRU") for approval or denial.[32] If a financial advisor received approval of an outside business activity or private securities transaction, the firm notified him or her by email.[33] The approval email reminded the financial advisor that future changes to the investment must be disclosed and approved before proceeding.[34] Merrill Lynch required financial advisors to certify annually that their disclosures were accurate and complete.[35]

IV. Findings of Violation

The violations alleged in the Complaint relate to Respondents' investments and business dealings away from Merrill Lynch. In this decision, we organize our discussion by investment or business and the violations alleged in connection with each investment or business. Because causes one, two, and seven relate to more than one investment or business, we discuss our findings related to those causes of action in multiple sections. Section IV.D contains a summary of our findings by cause.

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[26] Tr. 273; CX-66, at 3.

[27] Tr. 280-81; CX-66, at 3.

[28] Tr. 402-05.

[29] Tr. 729-38; CX-54; Respondent's Exhibit ("RX")-22, at 13-23.

[30] Tr. 454-56, 569-70; RX-27, at 8.

[31] Tr. 266-68, 594.

[32] Tr. 258, 265-71.

[33] Tr. 270; RX-92.

[34] Tr. 270; RX-92. The AIM system provided an opportunity for financial advisors to answer questions and submit additional information after the original disclosure. Tr. 284-86; CX-54. If a financial advisor's request was denied, he or she could appeal the denial to Merrill Lynch's general counsel. Tr. 293-94.

[35] Tr. 266, 283.

A. Lorax LLC (Causes One, Two, Three, and Four—Brown)

Brown formed Lorax in 2008.[36] In January 2008, Brown requested and received permission from Merrill Lynch to invest $100,000 in Lorax.[37] Brown disclosed, "Lorax is a limited liability company that will be owned by myself and my siblings … sole purpose of Lorax is to invest in Climax Global Energy … minimum investment is $250,000 thus the reason for forming Lorax – to get to that."[38] Brown admitted that, through Lorax, he pooled his money not only with his siblings, as he disclosed, but also with friends, and his disclosure therefore was inaccurate when made.[39]

In February 2010, Brown disclosed a second Lorax investment to Merrill Lynch. The disclosure form included the question, "Are you aware of any [Merrill Lynch] clients investing or participating in the offering?"[40] Brown answered "No."[41] Brown's disclosure form, which he attested to having read and understood, stated that Merrill Lynch employees must not pool funds with a client for purposes of an investment.[42] Brown admitted his disclosure was false because Merrill Lynch clients also had invested in Lorax.[43] He testified that, at the time, he did not appreciate the importance of full and complete disclosure and did not understand the significance of his misconduct.[44]

At some point, Lorax expanded and invested in FastCap Systems Corporation ("FastCap"), Windstream Technologies, Inc. ("Windstream"), and Cerion, LLC ("Cerion").[45] The form on which Brown disclosed Lorax also stated, "If the information provided in this outside interest request changes or becomes inaccurate then the employee must revise and resubmit their outside interest request for review."[46] Brown admitted he failed to update or revise his disclosure when Lorax invested in other private companies in addition to Climax Global.[47]

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[36] CX-56; RX-95; Tr. 756-58.

[37] CX-31.

[38] CX-31, at 4.

[39] Tr. 763-64; CX-31, at 4.

[40] CX-32, at 3.

[41] CX-32, at 3; Tr. 766.

[42] CX-32, at 4.

[43] Tr. 766-67, 778-79, 782-87.

[44] Tr. 763-65.

[45] Tr. 790-91.

[46] CX-32, at 4.

[47] Tr. 768, 791.

Brown testified that he tried to be transparent with respect to his private investments, but admitted he was negligent in failing to disclose customer involvement.[48] Brown stated that, because many of the clients who invested alongside him were friends who Brown accepted as customers even though they did not meet the P-BIG asset requirements, and Brown therefore did not earn commissions on their trades, he did not feel compelled to disclose their common investments.[49] Brown stated that he failed to appreciate the importance of such disclosures.[50]

In late 2010 or early 2011, Merrill Lynch flagged a check to Lorax drawn on Goetz's Merrill Lynch account.[51] Merrill Lynch thereafter confronted Brown about the extent of Lorax's investments and the identity of the investors in Lorax. In 2012, Brown voluntarily dissolved Lorax and disclosed the individual investments that resulted from Lorax's dissolution.[52] Merrill Lynch resolved the Lorax matter by placing a memo in Brown's and Goetz's employment files.[53]

1. Private Securities Transactions (Cause Three—Brown)

Cause three alleges that Brown violated NASD Rule 3040 and FINRA Rule 2010 by facilitating a material expansion of Lorax to include investments in Lorax by investors outside of Brown's immediate family, including Merrill Lynch customers, and by actively participating in Lorax's investment in three private companies beyond the one company disclosed, all without amending his original disclosure.

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[48] Tr. 776-77.

[49] CX-15; Tr. 777-78.

[50] Tr. 779.

[51] CX-44; Tr. 295-96. Page and Goetz differ in their recollection of events. Page testified that he contacted Goetz to ask what Lorax was, and Goetz misrepresented that it involved real estate. Tr. 297. Goetz testified that, although he had talked with Page about forming a limited liability company for real estate investments, he never stated that Lorax involved real estate. Tr. 1503-04, 1534-36. We find Goetz's testimony more credible. At the time of Page's conversation with Goetz, Page (with Wagner) was responsible for 120 financial advisors and was one of four managers overseeing six offices. Tr. 392, 1174-75. Page did not document in Merrill Lynch's records that Goetz lied, and Merrill Lynch took no disciplinary action against Goetz for lying to an administrative manager. Tr. 424-26. Goetz testified that, around the same time, he spoke to Page about real estate investments. Tr. 1503-04. These facts suggest to us that Page may have misunderstood Goetz, not that Goetz lied to Page. Furthermore, when Goetz invested in Lorax, Lorax was already an approved outside investment for Brown, so it is unlikely that Goetz would have expected a misrepresentation about Lorax to go undetected.

[52] Tr. 436-37, 1465; RX-83; RX-84; RX-85; RX-94.

[53] CX-16; RX-6; Tr. 439-46. Page signed the memo, dated March 26, 2012, although he did not draft it. CX-16; RX-6; Tr. 442-43. Page also did not discuss the memo with Brown and Goetz before or after placing it in their files. Tr. 443-44. Adams testified that he talked with them about Lorax, but did not show them the memo. Tr. 898, 1001. Brown does not recall Adams' speaking with him about Lorax disclosure issues and never saw the memo. Tr. 800-02. The memo states that Brown invested in companies alongside clients, but the clients confirmed that Brown neither solicited nor recommended the investments. CX-16; RX-6. The memo also states that Brown would be removed as broker of record on the client accounts, but he was not. Merrill Lynch allowed the customers to remain as Brown's clients. Tr. 455-56.

NASD Rule 3040 states that, prior to participating in any private securities transaction, an associated person shall provide written notice to the member firm with which he is associated, describing in detail the proposed transaction and the person's role in it and stating whether he has received or will receive selling compensation in connection with the transaction.[54] "Private securities transaction" is defined as any securities transaction outside the regular course or scope of an associated person's employment with a member.[55]

Brown does not dispute that the membership interests in Lorax were securities. Relying upon the seminal Supreme Court case *SEC v. Howey Co.*, 328 U.S. 293 (1946), FINRA's National Adjudicatory Council ("NAC") has held that there is an investment contract and, consequently, a security, where there is (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits, (4) to come solely from the efforts of others.[56] Applying these factors here, we find that investments in Lorax were securities. Brown and others invested funds in Lorax to form a common enterprise that pooled money to invest in several issuers with the expectation of deriving profits solely from these investments. The investors' funds were pooled, and they shared profits resulting from the actions of others. We find that the Lorax limited liability company interests were securities.

NASD Rule 3040 states that associated persons shall not participate "in any manner" in a private securities transaction except as permitted by the rule. The NAC and the Securities and Exchange Commission have broadly interpreted the phrase in Rule 3040 "participate in any manner."[57] Thus, although Brown did not sell interests in Lorax or solicit others to invest, his investment alone, away from Merrill Lynch, constitutes participation in a private securities transaction.[58] Brown provided prior written notice to Merrill Lynch of two investments in Lorax, but his disclosures either were or became inaccurate. He failed in the first disclosure in January 2008 to accurately disclose that the pool of Lorax investors would include individuals other than his siblings and in the second disclosure in February 2010 to correctly state that the pool of Lorax investors would include Merrill Lynch customers. Additionally, at some point, Lorax

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[54] NASD Rule 3040 was superseded by FINRA Rule 3280, which became effective September 21, 2015. Exchange Act Release No. 75757, 2015 SEC LEXIS 3471 (Aug. 25, 2015). The misconduct at issue in this case occurred prior to September 2015, so NASD Rule 3040 applies. *See Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 SEC LEXIS 2631, at *11-12 (Nov. 8, 2006) (stating the factors to establish a violation of Rule 3040). There is no allegation and no evidence suggesting Brown received selling compensation or any remuneration related to Lorax.

[55] *See* Rule 3040(e)(1).

[56] *Dep't of Enforcement v. Mielke*, No. 2009019837302, 2014 FINRA Discip. LEXIS 24, at *15 (NAC July 18, 2014), *aff'd*, Exchange Act Release No. 75981, 2015 SEC LEXIS 3927 (Sept. 24, 2015) (affirming finding that LLC interests are securities).

[57] *See Harry Friedman*, Exchange Act Release No. 64486, 2011 SEC LEXIS 1699, at *13-14 (May 13, 2011) ("As an initial matter, our cases have consistently affirmed a broad interpretation of Rule 3040 and its operative phrase, 'participate in any manner.'"); *Joseph Abbondante*, Exchange Act Release No. 53066, 2006 SEC LEXIS 23, at *28-29 (Jan. 6, 2006) ("Conduct Rule 3040 is broad in scope and is not limited merely to solicitation of an investment.").

[58] *Friedman*, 2011 SEC LEXIS 1699, at *14 (holding that respondent's initial purchase for himself of an issuer's shares as well as his subsequent sales to other investors constituted private securities transactions).

invested in companies other than the one company that Brown disclosed. Brown failed to update his disclosure accordingly, thereby making his representations to Merrill Lynch inaccurate.[59] Brown admitted to these inaccuracies.[60]

Brown argued that we should credit him because he did not solicit anyone to invest in Lorax or otherwise recommend it and his customers were not harmed. While we may consider these factors with respect to sanctions, they do not excuse Brown's violations of Rule 3040, which "serves not only to protect investors, but also to permit securities firms, which may be subject to liability in connection with transactions in which their representatives become involved, to supervise such transactions."[61] We find that Brown violated NASD Rule 3040 and FINRA Rule 2010 as alleged in cause three.[62]

2. Outside Business Activities (Cause Four—Brown)

Cause four alleges that Brown violated FINRA Rules 3270 and 2010 and NASD Rule 3030 by actively engaging in managing Lorax without amending his disclosure to reflect Lorax as an outside business activity.

Rule 3270, which became effective December 15, 2010, states, among other things, that no registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person or entity outside the scope of his relationship with his member firm unless he has provided prior written notice to the firm.[63] The purpose of Rule 3270 "is to ensure that firms receive prompt notification of all outside business activities of their associated persons so that the member's objections, if any, to such activities could be raised at a meaningful time and so that appropriate supervision could be exercised as necessary."[64] The

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[59] *Cf. Bernard G. McGee*, Exchange Act Release No. 80314, 2017 SEC LEXIS 987, at *35 (Mar. 27, 2017) (finding that prior notice of an outside business activity is valid only to the extent it continues to accurately describe the outside business activity and it therefore is "incumbent on the registered person to provide prior written notice before altering the nature of any outside business activity previously disclosed").

[60] Tr. 763-64, 766-68, 778-79, 782-87, 791.

[61] *Joseph J. Vastano, Jr.*, Exchange Act Release No. 50219, 2004 SEC LEXIS 1806, at *12-13 (Aug. 19, 2004) (citing *Mark H. Love*, Exchange Act Release No. 49248 (Feb. 13, 2004)).

[62] *See Friedman*, 2011 SEC LEXIS 1699, at *23 ("A violation of a Commission or NASD Rule or regulation also constitutes a violation of [Rule 2010]."); *Mielke*, 2014 FINRA Discip. LEXIS 24, at *8 ("A violation of any FINRA Rule, including NASD Rule 3040, violates NASD Rule 2110 and FINRA Rule 2010.").

[63] The precursor to FINRA Rule 3270 was NASD Rule 3030. Rule 3030, which applies to misconduct that occurred prior to December 15, 2010, states that no person associated with a member in any registered capacity "shall be employed by, or accept compensation from, any other person as a result of any business activity, other than a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member. Such notice shall be in the form required by the member."

[64] *Dep't of Enforcement v. Houston*, No. 2006005318801, 2013 FINRA Discip. LEXIS 3, at *32 (NAC Feb. 22, 2013), *aff'd*, Exchange Act Release No. 71589, 2014 SEC LEXIS 614 (Feb. 20, 2014) (citations omitted).

registered person must disclose the outside activity at a time when "steps are taken to commence a business activity unrelated to his relationship with his firm."[65]

Brown admitted he formed Lorax.[66] He retained a lawyer and accountant to create the limited liability company and file necessary papers with the State of New York.[67] Brown also operated Lorax as an entity for pooling money to invest in other companies. He provided Lorax's investors with wire instructions when they remitted investment funds.[68] He organized and facilitated three rounds of fundraising and kept records of individual investments.[69] He handled distributions to investors and, when he dissolved Lorax, distributions to investors of shares of the issuers in which Lorax had invested.[70] Additionally, Brown decided on behalf of Lorax to expand its original investment plan to include three additional private companies—FastCap, Windstream, and Cerion.[71]

Brown inaccurately disclosed his investment in Lorax only as a passive private securities investment. The sweep of FINRA Rule 3270 is necessarily broad to include any kind of business activity away from the firm.[72] The rule covers an array of activities, transactions, and relationships that occur outside the scope of an associated person's relationship with his member firm.[73] We find that Brown established, operated, and ultimately dissolved Lorax, and his participation was not only as a passive investor. By failing, in advance, to accurately disclose his involvement in operating Lorax, Brown violated NASD Rule 3030 (for misconduct prior to December 15, 2010) and FINRA Rules 3270 and 2010.[74]

3. Inaccurate Disclosures to Merrill Lynch (Cause One—Brown)

Cause one alleges, in part, an independent violation of FINRA Rule 2010 when Brown failed to disclose: the full scope of his participation in Lorax; that non-siblings, including Merrill

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[65] *Dep't of Enforcement v. Schneider*, No. C10030088, 2005 NASD Discip. LEXIS 6, at *13-14 (NAC Dec. 7, 2005).

[66] Tr. 756.

[67] CX-56; RX-95; Tr. 756-59.

[68] Tr. 819.

[69] Tr. 815-22; CX-49, at 9-13.

[70] Tr. 830-36, 1269-73; CX-49, at 11; CX-50; RX-83; RX-84; RX-85; RX-94.

[71] Tr. 774, 789, 790-91; CX-15.

[72] *Wanda P. Sears*, Exchange Act Release No. 58075, 2008 SEC LEXIS 1521, at *16 (July 1, 2008).

[73] *See Dep't of Enforcement v. Connors*, No. 2012033362101, 2017 FINRA Discip. LEXIS 2, at *15 (NAC Jan. 10, 2017) (holding that Rule 3270 requires associated persons to report any kind of business activity away from their member firms); NASD Notice to Members 01-79, 2001 NASD LEXIS 85, at *2 (Dec. 2001) (emphasizing that associated persons are required, under Rule 3030, to report "any and all types of business that they plan to conduct away from their firms").

[74] A violation of FINRA Rule 3270 constitutes a violation of FINRA Rule 2010. *See Dep't of Enforcement v. Moore*, No. 2008015105601, 2012 FINRA Discip. LEXIS 45, at *25 (NAC July 26, 2012).

Lynch customers, were invested; and that Lorax invested in three private companies in addition to Climax Global.

FINRA Rule 2010 requires members, in the conduct of their businesses, to observe high standards of commercial honor and just and equitable principles of trade. FINRA Rule 0140 applies the duties and obligations of members to associated persons. In cause one, Enforcement alleges that Brown violated Rule 2010 directly by misrepresenting facts about Lorax to his firm. "A registered representative who misleads his firm by providing inaccurate information violates NASD Rule 2110."[75]

Brown misrepresented his participation in Lorax as solely a passive investment when he also formed and operated it. He also misrepresented to Merrill Lynch that individuals other than his siblings, including customers, did not hold interests in Lorax and that Lorax invested in one company. Brown argued that Merrill Lynch understood from the facts he did disclose that he formed and operated Lorax. While Merrill Lynch may have understood some aspects of Lorax's operations and Brown's involvement in it, the fact remains that the information Brown provided to the firm was inaccurate and incomplete. Brown knew the information he disclosed was not complete and accurate, yet he made no effort to amend his disclosures until confronted by the firm. By acting in this manner, Brown violated Rule 2010, as alleged in cause one.[76]

4. Misrepresentations During the Firm's Internal Review (Cause Two—Brown)

Cause two alleges that Brown violated Rule 2010 by failing to disclose during a Merrill Lynch 2011 internal investigation of Lorax that customers invested in Lorax. When Merrill Lynch flagged Goetz's check to Lorax, the firm commenced an internal investigation and questioned Brown.[77] Brown admitted to Page that Lorax had expanded and become more extensive than he originally disclosed, and Brown voluntarily disbanded Lorax in an open and transparent way.[78] Adams testified that Brown never, during Merrill Lynch's investigation, denied customers' investments in Lorax.[79] On November 30, 2011, Brown sent an email to Page and Adams in which he answered the firm's questions about Lorax's investors.[80] In the email, Brown disclosed customers' investments in Lorax. Brown admitted he did not properly disclose two customers in that email.[81] In 2012, however, Brown voluntarily dissolved Lorax, identified

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[75] *Dep't of Enforcement v. Pierce*, No. 2007010902501, 2013 FINRA Discip. LEXIS 25, at *90 (NAC Oct. 1, 2013).

[76] *See Pierce*, 2013 FINRA Discip. LEXIS 25, at *87 (finding that respondent's misrepresentations to his member firm regarding customers' annuity purchases violated Rule 2110 (now Rule 2010)); *Dep't of Enforcement v. Davenport*, No. C05010017, 2003 NASD Discip. LEXIS 4, at *8-9 (NAC May 7, 2003) (finding respondent's false representations to his member firm regarding loans from customers violated Rule 2110).

[77] Tr. 781-83, 888-89; CX-15.

[78] Tr. 318-20, 435-37.

[79] Tr. 889, 892.

[80] Tr. 781-83; CX-15.

[81] Tr. 787.

all customers' investments, and disclosed the individual investments that resulted from Lorax's dissolution.[82] By March 2012, Merrill Lynch placed a warning memo in Brown's file and considered the Lorax issue fully resolved.[83] Merrill Lynch thereafter granted Brown an exception that enabled him to keep the Lorax investors as his customers.[84]

Enforcement is required to prove its allegations by a preponderance of the evidence.[85] We find that Enforcement did not prove by a preponderance of the evidence that Brown failed to disclose customer involvement in Lorax during Merrill Lynch's internal investigation, as alleged in cause two. Page and Adam testified that Brown fully cooperated during the Lorax investigation. The evidence shows that, although Brown's initial email was incomplete, he thereafter fully disclosed customer involvement in Lorax during the investigation. We dismiss the allegations related to Lorax in cause two.

B. Iron Smoke Whiskey and The Clean Energy Companies (Causes One, Two, Five, and Seven—Brown and Goetz)

1. Iron Smoke Whiskey

In late 2012, Brown co-founded Iron Smoke, a limited liability company, with the intention of distilling smoked whiskey.[86] Starting some time in 2013, Iron Smoke sold a smoked whiskey that it produced by contracting for the use of an existing distillery.[87] In the fall of 2014, Iron Smoke constructed its own distillery.[88]

In July 2012, Brown requested and received approval from Merrill Lynch for a $25,000 investment in Iron Smoke as a private securities transaction.[89] Brown disclosed his second investment of $50,000 in Iron Smoke in August 2013, and Merrill Lynch approved.[90] Brown testified that one of the three original investors, DL, encountered legal problems in early 2014.[91] Iron Smoke's owners became concerned that DL's legal problems could affect Iron Smoke's alcohol license, so RK, one of Brown's Merrill Lynch customers, purchased DL's interest from

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[82] Tr. 436-37, 1465; RX-83; RX-84; RX-85; RX-94.

[83] Tr. 551, 957, 1465; CX-16.

[84] Tr. 454-56.

[85] *See John D. Audifferen*, Exchange Act Release No. 58230, 2008 SEC LEXIS 1740, at *12 (July 25, 2008).

[86] Tr. 1231.

[87] Tr. 1235-36.

[88] Tr. 1238-39, 1240-41.

[89] Tr. 1208; CX-29.

[90] CX-30. Brown testified that he invested additional funds when Iron Smoke progressed from testing to contract distilling. Tr. 1221-23; CX-30.

[91] Tr. 1209.

DL.[92] Brown admitted RK was a Merrill Lynch customer, and he should have disclosed RK's ownership of Iron Smoke at that time, but did not.[93] Around the same time, Brown's brother also invested in Iron Smoke. Brown admitted he should have disclosed his brother's investment because his brother was a Merrill Lynch customer, but he did not.[94]

Initially, Iron Smoke employed an accountant to pay its bills. After DL sold his interest in Iron Smoke, Iron Smoke dismissed the accountant, and Brown temporarily became a signatory on the company's bank account and began paying its bills.[95] Brown also created a convertible note to document investors' interests in Iron Smoke.[96] Sometime in 2014, Brown appeared at a zoning variance meeting on behalf of Iron Smoke for construction of its distillery.[97] Brown also signed an alcohol permit for Iron Smoke.[98] Brown admitted he did not disclose these activities to the firm because he did not understand that such conduct could qualify as outside business activities. Brown testified that, at the point he became more active with Iron Smoke's operations, he should have revised his disclosure to Merrill Lynch to indicate his involvement in an outside business activity.[99]

a. Outside Business Activities (Cause Five—Brown)

Cause five alleges that Brown violated FINRA Rules 3270 and 2010 by actively engaging in managing Iron Smoke without amending his disclosure.[100]

Enforcement alleges that Brown should have disclosed his involvement in Iron Smoke as an outside business activity during the entire term of his involvement. Brown admitted he assumed additional responsibilities for Iron Smoke when RK bought DL's interest in early 2014. Brown testified, "It is true that after [DL] was no longer involved, I took a more active role and I

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[92] Tr. 1209-10, 1239, 1253.

[93] Tr. 1210, 1236.

[94] Tr. 1217, 1254.

[95] Tr. 1209, 1223, 1228-29.

[96] Tr. 1226-29.

[97] Tr. 1232-35, 1237-38.

[98] Tr. 1226-28.

[99] Tr. 1223, 1227-29, 1236, 1238-39, 1241.

[100] Rule 3270 states, among other things, that no registered person may be an employee, independent contractor, sole proprietor, officer, director, or partner of another person or entity outside the scope of his relationship with his member firm unless he has provided prior written notice to the firm. The registered person must disclose the outside activity at a time when "steps are taken to commence a business activity unrelated to his relationship with his firm." *Schneider*, 2005 NASD Discip. LEXIS 6, at *13-14. Rule 3270 is an important part of FINRA's regulatory framework because it ensures that member firms may raise objections to and exercise appropriate supervision over outside business activities. *McGee*, 2017 SEC LEXIS 987, at *36.

should have changed my disclosure and I did not, absolutely and that all occurred in 2014."[101] Brown paid Iron Smoke's bills for a six-month period, signed documents on behalf of the company, signed paperwork to obtain an alcohol permit, and represented Iron Smoke at a zoning variance meeting to enable the company to build a distillery. We find that Brown should have disclosed his involvement with Iron Smoke as an outside business activity after DL's departure.

We also find that Brown should have disclosed his involvement in Iron Smoke as an outside business activity before DL's departure. From the outset, Brown was instrumental in establishing Iron Smoke as a limited liability company.[102] He engaged a lawyer to file formation papers with the Secretary of State.[103] Although he was never the managing member, as a member of the limited liability company he held member signing rights.[104] At the time of Iron Smoke's formation, Brown talked with the director of development for a wine and beer distributor run by one of Brown's largest clients to determine if there was a market for smoked whiskey.[105] Although Brown may not have been running the distillery, we find that he was sufficiently active in forming Iron Smoke and commencing its operations to require his disclosure of Iron Smoke as an outside business activity from the time of Iron Smoke's inception.

b. Inaccurate Disclosures to Merrill Lynch (Cause One—Brown)

Merrill Lynch's investigation began when a Merrill Lynch operations manager discovered a check from Brown's customer, WT, payable to Iron Smoke and brought the matter to Adams' attention.[106] Adams contacted Brown, and Brown explained that the customer was not investing in Iron Smoke. Rather, the customer was lending money to his son, an apprentice distiller at Iron Smoke, to invest.[107] Adams asked Brown if other customers were invested in Iron Smoke, and Brown answered there were no other customers invested.[108] Adams stated that it was eventually decided that McGauley's team would work with Page to confirm that no other customers were involved in Iron Smoke.[109] Page reviewed a February 2014 common wire

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[101] Tr. 1236; *see also* Tr. 1241 ("Again at that point in time it should have been an outside business activity. I did not know that. I should have disclosed that, I fully admit that.").

[102] Tr. 1224-25.

[103] Tr. 1222.

[104] Tr. 1229-30.

[105] Tr. 1223-24.

[106] Tr. 912.

[107] Tr. 912-13. Brown produced a promissory note and other documentation to establish that customer WT loaned money to his son for his son to invest in Iron Smoke. Tr. 1037.

[108] Tr. 913. At the hearing, Brown did not specifically address what he told Adams during this conversation. Brown contended that, around this time, he was trying to work with McGauley and Bowes to resolve the inaccuracies in his investment disclosures, and McGauley suggested he not rely on Adams for help. Tr. 1347-48. Brown testified that he did not rely on Adams mainly because Adams was rarely available. Tr. 1382-83.

[109] Tr. 914.

destination report showing six instances in which Merrill Lynch customer accounts wired funds to a bank account in the name of Iron Smoke.[110] Page testified that, when he asked Brown if others of his customers were invested in Iron Smoke, Brown stated that he would not necessarily know because he was not aware of all of the wire instructions his customers gave to his client associates.[111]

Approximately six of Brown's customers invested in Iron Smoke in late 2013 and early 2014.[112] Brown admitted, under Merrill Lynch's policies, he should have disclosed the customers' investments, and he did not.[113] Merrill Lynch reassigned these customers to other financial advisors after learning of their investments in Iron Smoke.[114] Page thereafter began a more thorough investigation into Brown's other outside investments and asked Brown for a breakdown of all of his outside investments.[115]

Cause one alleges, in part, that Brown independently violated Rule 2010 by failing to disclose the full scope of his participation in Iron Smoke and Merrill Lynch customers' investments in Iron Smoke. Specifically, Enforcement argued that Brown misrepresented information in his initial disclosures of Iron Smoke and failed to update his disclosures after DL resigned, customers invested, and Brown accepted additional responsibilities. The principal consideration in finding a violation of Rule 2010 is "whether the misconduct reflects on an associated person's ability to comply with regulatory requirements necessary to the proper functioning of the securities industry."[116] Brown knew that he had accepted increasing responsibilities for Iron Smoke. He also knew firm customers had invested in Iron Smoke. He ignored these developments and made no effort to advise the firm. His failure to keep Merrill Lynch accurately apprised of his outside business activities and his willingness to surreptitiously invest alongside customers is exactly the type of misconduct at which Rule 2010 is directed. Brown's actions adversely reflect on his ability to comply with regulatory requirements, and we find that he violated Rule 2010 independently of his violations of Rule 3270.

While Merrill Lynch was investigating customer involvement in Iron Smoke, Goetz approached Page and requested permission to invest.[117] Goetz testified that Page initially stated that he did not see a problem with Goetz's investing in Iron Smoke, and Goetz knew that at least

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[110] Tr. 348-51, 1244; CX-22.

[111] Tr. 354-55.

[112] Tr. 1244-45, 1253-57; CX-22. Brown admitted that he was aware of their investments. CX-22. Brown spoke to some of the customers to provide direction for wiring funds to Iron Smoke. Tr. 1245.

[113] Tr. 1255.

[114] Tr. 356-57.

[115] Tr. 357, 365.

[116] *Dep't of Enforcement v. Taylor*, No. C8A050027, 2007 NASD Discip. LEXIS 11, at * 22 (NAC Feb. 27, 2007).

[117] Tr. 355-56, 511-12, 1514-16.

three other financial advisors had been approved to invest.[118] Page approached Goetz, however, shortly after their initial conversation and told him to "hold off" because of customer involvement.[119] Goetz admitted that, rather than heeding Page, he invested $25,000 in Iron Smoke in May 2014 without disclosing it on the AIM system.[120] Goetz testified, "I made a mistake and I moved forward and I invested without receiving formal approval. I own up to that. I made a mistake. I wish I did not do it."[121] Goetz testified that he believed he would receive eventual approval because others had, and he was eager to invest during the limited period open to new investors.[122]

c. Private Securities Transactions (Cause Seven—Goetz)

Cause seven alleges, in part, that Goetz violated Rules 3040 and 2010 by failing to get prior approval for his Iron Smoke investment. NASD Rule 3040 states that, prior to participating in any private securities transaction, an associated person shall provide written notice to the member firm with which he is associated describing in detail the proposed transaction and the person's role in it and stating whether he has received or will receive selling compensation in connection with the transaction.[123] Goetz admitted Page advised him to wait to invest in Iron Smoke while the firm determined exactly which of its customers were also invested.[124] Goetz nevertheless invested $25,000 in May 2014 without giving the firm prior written notice and without receiving permission.[125] We find that, in doing so, Goetz violated FINRA Rules 3040 and 2010, as alleged in cause seven.[126]

2. The Clean Energy Companies and Other Private Investments

Brown failed to disclose customer involvement in a number of his outside investments. Some of Brown's private investment disclosures were inaccurate when made in 2011 and 2013. Others were accurate when made, but subsequently became inaccurate as circumstances

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[118] Tr. 1514-15.

[119] Tr. 1515.

[120] Tr. 1355-56, 1514-18; CX-70.

[121] Tr. 1516.

[122] Tr. 1516-17, 1557.

[123] There is no allegation and no evidence suggesting Goetz received selling compensation or other remuneration related to Iron Smoke.

[124] Tr. 1515-16.

[125] Tr. 1514, 1517-18; CX-70, at 13-20, 62.

[126] Goetz's violation of Rule 3040 also constitutes a violation of Rule 2010. *See Friedman*, 2011 SEC LEXIS 1699, at *23. Goetz does not contend that his investment in Iron Smoke did not involve a security. We nevertheless have considered the issue. We find that Goetz's interest in Iron Smoke was a security. Goetz and others who invested in Iron Smoke expected the company to operate a smoked whiskey distillery independent of involvement from its investors and to derive profits from the company's efforts. We find that Goetz's investment in Iron Smoke meets the *Howey* test for whether an investment contract is a security. *See Mielke*, 2014 FINRA Discip. LEXIS 24, at *15.

changed. Several of these outside investments involved Brown customer AC, a successful Rochester businessman and Merrill Lynch client.[127]

AC enjoyed significant financial success,[128] as a result of which he donated $10 million to the Massachusetts Institute of Technology ("MIT") to fund an earth sciences initiative that supported research into clean energy and resulting start-up companies.[129] FastCap, FinSix Corporation ("FinSix"),[130] Ubiquitous Energy, Inc. ("Ubiquitous"), and Gradiant Corporation ("Gradiant") are among "The Clean Energy Companies" that AC funded through his MIT endowment.[131] AC's funding also spawned other start-up companies in which Brown invested.

In February 2010, Brown disclosed to Merrill Lynch his intention to invest $25,000 in Sweetwater Energy, Inc. ("Sweetwater").[132] In late 2011 or early 2012, AC became chief executive officer of Sweetwater.[133] JB, another of Brown's customers, worked for and invested in Sweetwater,[134] and other Brown customers also invested.[135] Brown was aware of AC's, JB's and other customers' involvement with Sweetwater.[136] Brown accurately disclosed that he learned of Sweetwater through AC and stated that AC did not have an active role in the company.[137] Brown testified that this was true at the time he completed the disclosure form, but it later changed.[138] Brown admitted he never updated the disclosure form to accurately reflect that AC became active in running Sweetwater.[139] Similarly, Brown accurately stated in the February 2010 disclosure form that other Merrill Lynch customers had not invested in

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[127] Tr. 532-33.

[128] In 1997, Brown invested, with Merrill Lynch approval, in AC's newly formed company. Tr. 751. AC's company was acquired by a public company, and its former majority shareholders, including AC, formed other companies that Merrill Lynch took public through Brown's investment banking referrals. Tr. 751, 1276-80. The Brown Group subsequently handled 401(k) and stock option plans for these companies, and many of the original company's executives became Brown Group clients. Tr. 751-52, 1277-87.

[129] Tr. 1288-90. AC served on the board of directors of MIT's earth sciences initiative and asked Brown to serve on the board as well. Tr. 1296. Brown disclosed the board service to Merrill Lynch, and Merrill Lynch approved. Tr. 1296-97.

[130] FinSix originally went by the name "OnChip." Tr. 1290.

[131] Tr. 1290-91; RX-97. In this decision, the term "The Clean Energy Companies" represents FastCap, FinSix, OnChip, Ubiquitous, and Gradiant.

[132] Tr. 1321-22; CX-41.

[133] Tr. 1293-95.

[134] Tr. 1319-20.

[135] Tr. 1321.

[136] Tr. 1320-21, 1325-26; CX-49, at 21.

[137] Tr. 1321-22; CX-41, at 2.

[138] Tr. 1322.

[139] Tr. 1322. Brown testified that he also should have amended the form to indicate that client JB became active in running Sweetwater. Tr. 1325.

Sweetwater, but he failed to update the disclosure form when JB and other Merrill Lynch customers invested.[140]

In February 2011, Brown disclosed to Merrill Lynch his intention to invest $10,000 in OncoPep, Inc. ("OncoPep").[141] Brown learned of OncoPep from customer EP.[142] EP had invested in OncoPep and eventually served on and became chair of its board of directors.[143] Brown knew EP and other Merrill Lynch customers had invested in OncoPep.[144] Brown admitted he stated on his OncoPep disclosure form that he learned of OncoPep from EP without stating that she was a client.[145] He also admitted he falsely represented to Merrill Lynch that no Merrill Lynch customers were affiliated with or invested in OncoPep.[146] Brown further admitted he never amended the OncoPep disclosure form to accurately reflect Merrill Lynch customers' investments in OncoPep.[147]

In November 2011, Brown disclosed to Merrill Lynch his intention to invest $50,000 in Drive Safe Inc. ("Drive Safe").[148] Brown learned of Drive Safe through Merrill Lynch customer AC.[149] AC formed Drive Safe and invested in it.[150] Brown admitted that he disclosed he had learned of Drive Safe from a friend without stating that the friend was AC, a Merrill Lynch customer.[151] He also admitted he falsely represented to Merrill Lynch that no Merrill Lynch customers were affiliated with Drive Safe when several customers in addition to AC were investors.[152] Brown admitted he never amended the disclosure to accurately reflect Merrill Lynch customers' investments in Drive Safe.[153]

In March 2013, Brown disclosed to Merrill Lynch his intention to invest $50,000 in FinSix predecessor company OnChip.[154] Brown admitted he falsely stated that he learned of the

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[140] Tr. 1322-23; CX-41, at 3. Although Merrill Lynch knew that AC, a client of Brown's, invested in Sweetwater, the firm approved Brown for investment as well. Tr. 565-66.

[141] Tr. 1335; CX-42.

[142] Tr. 1334.

[143] Tr. 1334-35.

[144] Tr. 1334-35, 1337-38; CX-42, at 5.

[145] Tr. 1335-36; CX-42, at 3.

[146] Tr. 1336-37; CX-42, at 4.

[147] Tr. 1337.

[148] Tr. 1330-31; CX-43.

[149] Tr. 1327.

[150] Tr. 1327-28.

[151] Tr. 1331-32; CX-43, at 3.

[152] Tr. 1332-33; CX-43, at 4; CX-49, at 24.

[153] Tr. 1333-34.

[154] Tr. 1298-99; CX-39.

company from a family member, when in truth he learned of the company from client AC and the MIT earth sciences initiative.[155] He also admitted he falsely stated he was not the financial advisor of record for principals or directors of OnChip when, at the time, customer AC was a principal or director.[156] Brown further admitted he falsely answered "no" to the question of whether any of his customers had invested in OnChip, when AC and other customers were investors.[157]

In March 2013, Brown disclosed to Merrill Lynch his intention to invest $25,000 in Ubiquitous.[158] Brown admitted he falsely stated he learned of the company because it was located in the same building as another private company in which he invested when, in truth, he learned of the company from client AC and the MIT earth sciences initiative.[159] He also admitted he falsely stated he was not the financial advisor of record for principals or directors of Ubiquitous when, at the time, AC was a principal or director.[160] Brown further admitted he falsely answered "no" to the question of whether any of his customers had invested in Ubiquitous, when AC and other customers were investors.[161]

In October 2013, Brown disclosed to Merrill Lynch his intention to invest $25,000 in FastCap.[162] Brown admitted he falsely stated he learned of the company from the dissolution of Lorax, when in truth he learned of the company from client AC and the MIT earth sciences initiative.[163] He also admitted he knew and failed to disclose that AC and other customers were investors.[164]

In October 2013, Brown disclosed to Merrill Lynch his intention to invest $50,000 in Gradiant Corporation ("Gradiant").[165] Brown admitted he falsely stated he learned of the company through the chief executive officer of another of his private investments, when in truth he learned of the company from client AC and the MIT earth sciences initiative.[166] Brown also

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[155] Tr. 1299; CX-39, at 3.

[156] Tr. 1300-01; CX-39, at 4.

[157] Tr. 1301-04; CX-39, at 4; CX-49, at 27.

[158] Tr. 1305; CX-38.

[159] Tr. 1305-06; CX-38, at 3.

[160] Tr. 1306; CX-38, at 4.

[161] Tr. 1307-09; CX-38, at 4; CX-49, at 25.

[162] Tr. 1310; CX-37.

[163] Tr. 1305-06; CX-38, at 3.

[164] Tr. 1311-13; CX-37; CX-49, at 20.

[165] Tr. 1313; CX-40.

[166] Tr. 1313-14, 1318-19; CX-40, at 3.

admitted he falsely advised Merrill Lynch that no Merrill Lynch customers or financial advisors had invested in Gradiant when in actuality AC and other customers were investors.[167]

Brown testified that, in the past, the P-BIG managers in Boston had helped him resolve similar disclosure issues, and he had been approved to invest away from the firm alongside clients on some occasions.[168] Brown wrongly assumed the same would occur again. Brown admitted he was responsible for disclosing outside investments inaccurately.[169] He contended that he allowed himself to get sidelined by the demands of his business and admitted he should have been more diligent.[170]

a. Inaccurate Disclosures to Merrill Lynch (Cause One—Brown)

Cause one alleges, in part, that Brown violated Rule 2010 by failing to disclose that Merrill Lynch customers invested in The Clean Energy Companies, Sweetwater, OncoPep, and Drive Safe. The evidence supports this allegation. As detailed above, Brown admitted his disclosures to Merrill Lynch were inaccurate with respect to how he learned of the outside investments and customers' involvement with and investment in these companies. We find that Brown's misrepresentations to Merrill Lynch violated FINRA Rule 2010.[171]

b. Private Securities Transactions (Cause Seven—Goetz)

Cause seven alleges, in part, that Goetz violated Rules 3040 and 2010 by failing to provide prior written notice of and obtain prior approval for investing in FastCap, FinSix, Gradiant, and Ubiquitous. Goetz invested $25,000 each in FastCap, FinSix, and Ubiquitous and $10,000 in Gradiant between May 2012 and May 2013.[172] Goetz admitted he did not disclose these investments to Merrill Lynch or obtain permission to invest from Merrill Lynch before investing.[173] Goetz does not dispute that these investments were securities. We find that Goetz's actions violated Rules 3040 and 2010 as alleged in cause seven.[174]

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[167] Tr. 1317; CX-40, at 3; CX-49, at 26.

[168] Tr. 804-05, 1349, 1357, 1360-63, 1364, 1376, 1383-84.

[169] Tr. 1349-50.

[170] Tr. 1349-50.

[171] *See Howard Braff*, Exchange Act Release No. 66467, 2012 SEC LEXIS 620, at *16-17 (Feb. 24, 2012) (holding that registered representative who misrepresented to his firm that he held no outside brokerage accounts violated Rule 2110 (now 2010)); *Dep't of Enforcement v. Harari*, No. 2011025899601, 2015 FINRA Discip. LEXIS 2, at *16 (NAC Mar. 9, 2015) (finding that providing false information to a member firm violates FINRA Rule 2010).

[172] Tr. 1519-24, 1525-26; CX-70, at 1-2, 60.

[173] Tr. 1500-01, 1516, 1518-20.

[174] *Blair C. Mielke*, Exchange Act Release No. 75981, 2015 SEC LEXIS 3927, at *45 (Sept. 24, 2015) (finding that violations of Rules 3030 and 3040 constitute violations of FINRA Rule 2010); *Friedman*, 2011 SEC LEXIS 1699, at *23 (finding violations of Rule 3040 where associated person failed to provide written notice to his firm before engaging in transactions away from the firm).

3. Merrill Lynch's Investigation and Dismissal of Respondents (Cause Two—Brown)

Page's 2014 investigation of Brown's outside investments showed that some of Brown's clients were officers, principals, or investors in the small private companies in which Brown had invested.[175] Page brought his findings to Bowes and McGauley.[176] Page thereafter asked Brown to explain all client involvement in his outside investments and businesses.[177]

On July 23, 2014, Brown sent an email response to Page, in which he listed more than 20 outside investments or business ventures. [178] Brown testified that he intended this email to be a starting point for discussion with Page, Bowes, and McGauley to amend his inaccurate disclosures.[179] Brown indicated in the email to Page, "for you to review – don't send on until you and I have spoke [*sic*]."[180]

In the email, Brown accurately stated about FastCap that some of Brown Group's clients had acquired positions that would need to be disclosed.[181] About Gradiant, he stated he was unsure if customers were involved.[182] Brown knew that Merrill Lynch customers were involved with or invested in Gradiant.[183] Brown stated, with respect to OnChip, "no client involvement that I know of."[184] Brown admitted he knew that clients were invested, and he also knew an

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Brown and Goetz contended that, at various times in 2013 and early 2014, they sought assistance from management with their outside investment disclosures and received little help. Tr. 678, 805, 1344-50, 1360-64, 1376, 1382-84, 1525-27, 1544-45, 1547-49, 1551-55. Merrill Lynch's management denied that Brown and Goetz attempted to obtain assistance or amend their private investment and outside business disclosures before the firm began its investigation. Tr. 377, 380-82, 1048-49, 1109. On this conflicting testimony, we need not make a credibility determination because we do not need to decide whether Brown and Goetz sought assistance from management in order to find the violations alleged. As registered representatives, Brown and Goetz were responsible for complying with FINRA's rules. A registered person cannot shift responsibility for compliance to firm principals. *See Vincent M. Uberti*, Exchange Act Release No. 58917, 2008 SEC LEXIS 3140, at *15 (Nov. 7, 2008) (holding that registered person has independent duty to comply with regulatory requirements despite reliance on a firm principal); *Jeffrey D. Field*, 51 S.E.C. 1074, 1076 (1994) (finding that registered person is responsible for regulatory compliance regardless of a lack of knowledge, understanding, or appreciation for the importance of those requirements).

[175] Tr. 358. Page conducted online research and found additional connections between Goetz's customers, Brown's customers, and Brown's outside investments, including The Clean Energy Companies. Tr. 357-59.

[176] Tr. 358-59. Page was removed from the investigation in late July 2014. Tr. 642.

[177] Tr. 365-66; CX-27.

[178] CX-27.

[179] Tr. 1375, 1383-84.

[180] CX-27, at 1.

[181] Tr. 1368-69; CX-27, at 2.

[182] CX-27, at 2.

[183] Tr. 1370.

[184] CX-27, at 2.

amended disclosure would be needed because the company had changed its name to FinSix.[185] As to OncoPep, Brown stated "no client involvement that I know of."[186] Again, Brown testified he wrote this intending for it to start a dialogue because it was not accurate as written.[187] For Sweetwater, Brown accurately noted that customer AC was the chief executive officer.[188] Brown wrote for Ubiquitous, "no client involvement that I know of."[189] Brown admitted this was false, but stated that he hoped to start a dialogue.[190]

Merrill Lynch investigated whether Brown and Goetz had solicited any of their clients to invest in the private investments at issue here. The firm concluded that they had not.[191] Merrill Lynch terminated Brown and Goetz at the conclusion of its investigation in September 2014.[192]

Cause two alleges, in part, that Brown violated Rule 2010 during Merrill Lynch's 2014 internal investigation by failing to fully disclose customer involvement in The Clean Energy Companies, Sweetwater, and OncoPep in the July 2014 email to Page. Brown admitted many of his entries in the July 2014 email were inaccurate. He argued, however, that he intended the email to start a dialogue and included the statement "don't send on until you and I have spoke [*sic*]."[193] If Brown wanted to discuss the email and his disclosures with Page, the onus was on Brown to make that happen. Brown cannot now contend that his misrepresentations in the July 2014 email should be excused because Page failed to circle back to discuss them with him.[194] We find that Brown's conduct during Merrill Lynch's 2014 investigation violated Rule 2010 as alleged in cause two.

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[185] Tr. 1371-73.

[186] CX-27, at 3.

[187] Tr. 1385-87.

[188] CX-27, at 3.

[189] CX-27, at 3.

[190] Tr. 1388-89. Brown's statements in the July 2014 email regarding Iron Smoke and Drive Safe were accurate. Tr. 1368; CX-27, at 2.

[191] Tr. 573-74, 634; RX-18, at 63-82.

[192] CX-1, at 18; CX-2, at 16; Tr. 1429, 1572-73.

[193] CX-27; Tr. 1367, 1369, 1370-73, 1375-76, 1385, 1388-89. Page waited five days, until July 28, 2014, before emailing Brown, "When do you want to talk this over." CX-27, at 1. Brown responded, "tomorrow." Page testified that they did not speak on July 29, 2014. Tr. 538. Page also received an email from Brown on July 31, 2014, regarding MIT-related outside investments. Tr. 542-43; RX-11.

[194] *Cf. Friedman*, 2011 SEC LEXIS 1699, at *18-19 (holding that an associated person cannot shift his responsibility for disclosing outside securities sales to the member firm); *Dep't of Enforcement v. Meyers*, No. C3A040023, 2007 NASD Discip. LEXIS 4, at *24-25 (NAC Jan. 23, 2007) (finding that an associated person cannot hide behind reliance on his employer to insulate himself from liability for failing to disclose sales incentives).

C. Client Associate AS (Cause Six—Brown)

Cause six alleges that it is inconsistent with high standards of commercial honor and just and equitable principles of trade to take steps to circumvent a firm's compliance system. Cause six alleges that Brown directed AS, a client associate in the Brown Group, to alter the name of the payee on a check request for the purpose of circumventing Merrill Lynch's OFAC compliance system.

In 2011, Brown requested additional help for his team. In response, Merrill Lynch management assigned client associate AS to the Brown Group.[195] In July 2013, customer DP requested a check drawn from his Merrill Lynch account made payable to "Jose Rodriguez," an individual from whom he intended to purchase a motorcycle.[196] AS processed the check request.[197] Merrill Lynch crosschecks such requests with the Specially Designated Nationals and Blocked Persons list maintained for OFAC compliance. Almost immediately, AS's check request was flagged because the payee's name matched a name on the list.[198] OFAC compliance personnel requested additional identifying information for the payee on the check, such as Social Security Number, date of birth, or other identifying information.[199] AS testified that she immediately told Brown, and Brown refused to allow her to contact DP to request additional information.[200]

Brown testified that he was on a conference call when AS interrupted to tell him that DP was in the office requesting a check, and there was an issue with "OFAC."[201] Brown asked AS to forward the OFAC email to him.[202] Brown emailed Merrill Lynch's OFAC compliance group,

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[195] Tr. 710-11. Brown testified that Adams offered to add AS to the Brown Group because organizational changes in AS's former department would result in the elimination of her job. Tr. 713. Adams denied this, but he agreed that AS was "having other issues" before joining the Brown Group. Tr. 967-68. McGauley also testified that AS had performance issues before joining the Brown Group. Tr. 1126-27. Furthermore, McGauley testified that Brown complained to him about AS's performance issues after she joined the Brown Group. Tr. 1127. AS testified she was unaware of any performance issues. Tr. 101.

[196] Tr. 127-28. It is unclear how AS received this request. AS testified that Brown came out of his office and told her DP had texted him, stated he was en route to the Rochester office, and requested that they have a check ready for pick up payable to "Jose Rodriguez." Tr. 127. Brown testified that he was on a conference call when DP appeared at the Rochester office in person and requested the check directly from AS or another member of the Brown Group. Tr. 837-38. During cross examination, AS could not recall how she received the check request or how she knew the correct spelling of the payee's name. Tr. 186. AS also recalled that the check amount was $6,000, when in fact it was $4,300. Tr. 183, 609; RX-77, at 3.

[197] Tr. 127-28; CX-17; CX-20.

[198] Tr. 128; CX-17; CX-18; CX-20; CX-21; RX-77; RX-78.

[199] Tr. 128.

[200] Tr. 129.

[201] Tr. 838. Neither Brown nor AS were familiar with OFAC. Tr. 187-88, 838.

[202] Tr. 838.

noting that the client was in the office waiting for a check and asking if there was any way to issue the check for the client.[203]

AS testified that Brown stood outside his office while she called Page to request assistance.[204] She testified that Page's response was "good luck with that," and Brown then told her to change the payee's name on the check.[205] According to AS, she asked Brown if he intended for her to remove the "z" from the end of "Rodriguez," and Brown answered affirmatively.[206] Brown denied AS's version of events. Brown testified that AS came into his office a second time while he was still on the phone and told him that Page had not helped. Brown testified that he told AS to use an initial or get an initial.[207] Brown intended for AS to get and use a middle initial, which would have satisfied the OFAC requirements.[208]

AS attempted to withdraw her check request.[209] She testified that, at Brown's direction, she issued a new check request in which she changed the name of the payee to "Jose Rodrigue."[210] The evidence shows, however, that she actually changed the name to "J. Rodrigue," dropping the letter "z" from the last name and abbreviating the first name.[211]

The next day, Brown obtained additional information about Jose Rodriguez from DP, and confirmed that the payee on the check was not the individual on the Specially Designated Nationals and Blocked Persons list.[212] Merrill Lynch commenced an investigation into the Brown Group's handling of the OFAC alert.[213]

We observed both Brown and AS during their testimony. We find Brown's testimony to be more credible and supported by other evidence. First, we note that AS's memory of the pertinent events was flawed. She was mistaken about the amount of the check at issue. She contradicted her own earlier testimony that several people in the office heard Brown tell her to

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[203] Tr. 838.

[204] Tr. 130-31.

[205] Tr. 131. AS testified that she was dissatisfied with Page's response and later complained to Adams about Page's unwillingness to help. Tr. 207-08. Adams had no recollection of AS's complaining about Page. Tr. 969.

[206] Tr. 131, 139-40, 193, 245. At the hearing, AS testified that all other Brown Group customer associates were out of the office that day, so she and Brown were alone in the office. Tr. 127, 182-83, 194, 199-201. When AS testified on the record prior to the hearing, however, she testified that several Brown Group client associates were in the office that day and "they all heard" Brown tell her to "drop the Z" from Rodriguez. Tr. 199-201.

[207] Tr. 838-39, 848-49, 853-54.

[208] Tr. 848-49, 853-54. Page testified that a middle initial would have satisfied the OFAC requirements. Tr. 599.

[209] CX-17, at 1-2; RX-78, at 2; Tr. 335-36.

[210] Tr. 193, 211.

[211] Tr. 211-14, 226; CX-20.

[212] Tr. 610-11, 841-42; RX-77, at 1.

[213] RX-77, at 2.

change the payee's last name. She recalled Brown standing outside his office giving her direction, while he testified he was in his office on a conference call. She also claimed to have complained to Adams about Page's unwillingness to help her, but Adams recalled no such conversation. Additionally, on cross examination, AS became less certain as to how she received the directive to request a check for DP and how she learned the correct spelling of "Jose Rodriguez."

Second, Merrill Lynch's documentation of this event does not support AS's claim that Brown told her to drop the "z" from Rodriguez's last name. Page prepared an email to respond to OFAC's inquiry.[214] On July 16, 2013, the day after AS's original check request, Page wrote an email in which he stated that DP told Brown to change the name on the check to "J. Rodriguez," and Brown relayed that request to AS, but AS instead entered a request for a check payable to "J. Rodrigue."[215] Page's email does not indicate that Brown directed AS to drop the "z" from "Rodriguez," as AS testified. Enforcement argued that Page drafted this email after speaking only with Brown, not AS. Page testified, however, that he believed AS told him her version of the events at issue.[216] Additionally, we find it difficult to believe that Page, as an administrative manager, would not have asked AS, the individual who issued the check request, to provide her version of events if he was conducting an internal investigation. At the hearing, Page offered the explanation that his July 16, 2013 email contained typographical errors (his failing to drop the "z" from the name Rodriguez in two instances).[217] Page stated that he noticed the errors for the first time during his testimony.[218] Given that the purported purpose of the email was to document that Brown directed AS to change the name on a check to avoid an OFAC investigation, we find it difficult to believe that two misspellings in the name change at issue would go undetected in an email that contained only approximately 100 words. Additionally, the third reference in the email to the payee's name correctly stated that AS requested a check payable to "Rodrigue," without the "z."

In October 2013, Brown accepted a letter of reprimand relating to this incident.[219] It states that the firm concluded that Brown "directed [AS] to reissue a check request by abbreviating the check recipient's name."[220] We find that, if Merrill Lynch had in fact concluded that Brown directed AS to change the name "Rodriguez" to "Rodrigue," the firm would not have referred to Brown's actions as "abbreviating the check recipient's name." In our view, changing

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[214] RX-77, at 1-2.

[215] RX-77, at 2.

[216] Tr. 342.

[217] Tr. 613-15.

[218] Tr. 613-15.

[219] CX-21; RX-7; Tr. 846, 849. Brown testified that he accepted the letter of reprimand as the head of the Brown Group, acknowledging his responsibility for a problem within the group. After accepting a letter of reprimand, Brown hired a consultant that he personally paid to resolve communications issues in the Brown Group. Tr. 847.

[220] CX-21, at 1.

"Jose Rodriguez" to "J. Rodriguez" is a common type of abbreviation. Changing "Rodriguez" to "Rodrigue" is a less common practice and is in fact altering a last name.

Furthermore, we note that AS felt wronged by Merrill Lynch and Brown, suggesting to us that her memory may have been affected by her ill feelings. Merrill Lynch terminated AS on September 9, 2014, for completing documents after obtaining client signatures, utilizing client log-in information to access client accounts, and notarizing client signatures without having the client present.[221] AS admitted she completed documents after obtaining client signatures on them.[222] She understood this to be an acceptable practice at Merrill Lynch.[223] AS stated that a Brown Group customer associate trained her to utilize client log-in information to access client accounts to pay bills for clients.[224] AS also admitted to notarizing "dozens" of client signatures without clients present.[225] AS acknowledged that she thought this conduct was wrong, but never brought her concern to Merrill Lynch management.[226]

Finally, we credit Brown's argument that it defies logic that he would suggest AS change a check payee's name from "Rodriguez" to "Rodrigue," because that presumably would interfere with cashing the check. Given Brown's attention to client service, we find it unlikely that he would jeopardize his client's ability to use the check or the payee's ability to cash the check by so obviously changing the payee's last name. For all of these reasons, we are not convinced that Brown directed AS to change a check payee's name to avoid an OFAC alert. Rather, we credit Brown's claim that he directed AS to use an initial and intended for her to get the payee's middle initial.

We find that Enforcement failed to prove by a preponderance of the evidence the allegations contained in cause six and therefore dismiss it.

D. Summary of Findings by Cause

Under cause one, we find that Brown violated FINRA Rule 2010 by failing to disclose, in compliance disclosures and in response to inquiries, (1) the full scope of his participation in Lorax and Iron Smoke, (2) that customers were invested in Lorax, Iron Smoke, The Clean Energy Companies, OncoPep, Sweetwater, and Drive Safe, and (3) that customers AC and EP served as principals or directors for some of these companies. We also find that Brown failed to disclose that he expanded Lorax to non-siblings, including Merrill Lynch customers, and participated in Lorax's investment in three undisclosed private companies.

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[221] CX-3, at 4.

[222] Tr. 160-61.

[223] Tr. 161-62.

[224] Tr. 164-65.

[225] Tr. 166-67.

[226] Tr. 168-69.

Under cause two, we find that during Merrill Lynch's internal investigation of Brown's investments in The Clean Energy Companies, OncoPep, and Sweetwater, Brown violated FINRA Rule 2010 by failing to disclose, or misrepresenting, that customers were investors and principals or directors of these companies. We dismiss under cause two allegations that Brown violated Rule 2010 by making similar misrepresentations or omitting similar facts during Merrill Lynch's investigation of Lorax.

Under cause three, we find that Brown violated FINRA Rule 2010 and NASD Rule 3040 by participating in a material expansion of Lorax without amending his original disclosure of Lorax as a private securities transaction. Under cause four, we find that Brown violated FINRA Rules 2010 and 3270 and NASD Rule 3030 by actively engaging in the business of managing Lorax without disclosing it as an outside business activity.

Under cause five, we find that Brown violated FINRA Rules 2010 and 3270 by failing to disclose Iron Smoke as an outside business activity, even though he was actively engaged in Iron Smoke's business.

We find that Enforcement failed to prove the allegations in cause six by a preponderance of the evidence and therefore dismiss cause six.

Under cause seven, we find that Goetz violated FINRA Rule 2010 and NASD Rule 3040 by investing in Iron Smoke and The Clean Energy Companies without providing prior written notice to, and receive prior written permission from, Merrill Lynch before participating in these private securities transactions.

V. Sanctions

A. Brown

FINRA's Sanction Guidelines ("Guidelines") advise that it may be appropriate to aggregate similar violations if the violative conduct was unintentional or negligent (that is, did not involve manipulative, fraudulent, or deceptive intent), did not result in injury to the investing public, or the violations resulted from a single systemic problem or cause that has been corrected.[227] As directed by the Sanction Guidelines, we have considered these factors and find that aggregation is appropriate in this case. Brown's misconduct did not result in injury to the investing public, and the violations resulted from a single systemic problem that has been corrected. As to whether we find Brown's actions to be intentional or negligent, we have considered several factors. We find that Brown did not act with a manipulative or fraudulent intent. Rather, Brown exhibited a cavalier attitude towards compliance. He knowingly provided incomplete and incorrect information when he disclosed the outside activities and investments at issue in this case. We credit his statement that, in the past, Merrill Lynch management enabled this conduct by assisting him in fixing mistakes without repercussions. While we do not find that

[227] FINRA Sanction Guidelines at 4 (2017), http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf.

this excuses his misconduct or mitigates sanctions, we have considered it in determining whether to aggregate violations for purposes of sanctions.

We aggregate Brown's violations for purposes of sanctions. We find his violations relate to his ongoing failure to appreciate the importance of full and accurate disclosure of his outside business activities and investments.[228] In light of the many factors at play in this case and the seriousness of the violations,[229] we conclude that a meaningful sanction is required. Thus, we suspend Brown from associating with any member firm in any capacity for nine months and fine him $125,000. We assess these sanctions as follows: a three-month suspension and $25,000 fine for Brown's violations related to Lorax, and a six-month suspension and $100,000 fine for Brown's violations related to Iron Smoke, The Clean Energy Companies, OncoPep, Sweetwater, and Drive Safe.

1. Lorax-Related Violations

We start with Brown's Lorax-related violations of FINRA Rules 2010 and 3270 and NASD Rules 3030 and 3040 under causes one, three, and four.[230] Brown disclosed Lorax solely as a private securities transaction when he should have also disclosed it as an outside business activity. He also should have disclosed that individuals other than his immediate family, including Merrill Lynch customers, had invested in Lorax and Lorax had invested in additional private companies. The Guidelines for private securities transactions recommend a fine of $5,000

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[228] *See Mielke*, 2014 FINRA Discip. LEXIS 24, at *55 (imposing one sanction for undisclosed private securities transactions and outside business activities because they were related violations) (citing *Dep't of Enforcement v. Fox & Co. Inv., Inc.*, No. C3A030017, 2005 NASD Discip. LEXIS 5, at *37 (NAC Feb. 24, 2005) ("[W]here multiple, related violations arise as a result of a single underlying problem, a single set of sanctions may be more appropriate to achieve NASD's remedial goals ...."), *aff'd*, 58 S.E.C. 873 (2005); *Dep't of Enforcement v. Hardin*, No. E072004072501, 2007 NASD Discip. LEXIS 24, at *15 (NAC July 27, 2007) (upholding Hearing Panel determination to batch violations for purposes of sanctions where misconduct stemmed from a continuous course of action); *Dep't of Mkt. Regulation v. Ko Sec., Inc.*, No. CMS000142, 2002 NASD Discip. LEXIS 18, at *27 (NAC Nov. 13, 2002) (holding that it may be appropriate to aggregate similar violations for sanctions purposes where the conduct is not fraudulent).

[229] We cannot overstate the importance of compliance with FINRA Rule 3270 and NASD Rule 3040. Both rules serve the important function of enabling member firms to monitor, control, and supervise their associated persons' outside business activities, private investments, and securities sales away from the firm. *See McGee*, 2017 SEC LEXIS 987, at *36 (holding that Rule 3270 "ensures that member firms may raise objections to an associated person's outside business activities at a meaningful time and exercise appropriate supervision"); *Friedman*, 2011 SEC LEXIS 1699, at *35 ("[T]he prohibition on private securities transactions is fundamental to an associated person's duty to his customers and his firm."); *Houston*, 2013 FINRA Discip. LEXIS 3, at *31(stressing Rule 3270's function as a tool for member firms to prohibit or supervise associated person's outside businesses); *Dep't of Enforcement v. Carcaterra*, No. C10000165, 2001 NASD Discip. LEXIS 39, at *8-9 (NAC Dec. 13, 2001) (stating that Rule 3040 ensures member firms adequately supervise securities transactions away from the firm and protects member firms from claims related to outside securities transactions).

[230] Cause two also alleged Lorax-related violations, which we dismiss.

to $73,000 and a range of suspensions.[231] The Guidelines for outside business activities recommend a fine of $2,500 to $73,000 and a suspension of 10 business days to three months, or more if aggravating factors are present.[232] Because Brown misrepresented his outside activities and investments to Merrill Lynch, we also consider the Guidelines for misrepresentations and material omissions, which recommend a fine of $2,500 to $73,000 and a suspension for 31 calendar days to two years for negligent misconduct and more for intentional or reckless misconduct.[233] Additionally, the Guidelines for recordkeeping violations are analogous because Brown's failure to disclose customer involvement in his outside investments and his involvement in outside business activities caused Merrill Lynch to maintain inaccurate books and records.[234] For recordkeeping violations, the Guidelines recommend a fine between $1,000 and $15,000 and a suspension in any or all capacities for up to three months. Where aggravating factors predominate, the Guidelines recommend a fine of $10,000 to $146,000 and a suspension of up to two years or a bar.[235]

The recordkeeping principal considerations focus on the nature and materiality of the inaccurate or missing information and whether the violations allowed other misconduct to occur or escape detection. There are no principal considerations specific to misrepresentations and material omissions of facts. Most of the principal considerations specific to selling away/private securities transactions and outside business activities apply to sales to customers and therefore do not apply here.

We consider it mitigating that Brown advised Merrill Lynch he had formed Lorax as an investment vehicle.[236] We find it aggravating, however, that Lorax involved firm customers as

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[231] *See* Guidelines at 14. The Guidelines address selling away and private securities transactions together. We find that the private securities transactions in which Brown engaged—his investments in Lorax—are a less significant violation than selling away to a customer. The Guidelines recommend that the adjudicator impose a suspension based on the dollar amount of sales to customers, the number of customers, and the length of time over which selling away occurred, and impose a suspension based specifically on the dollar amount of the sales away to customers. For instance, the Guidelines recommend that, for up to $100,000 in sales to customers, the adjudicator impose a suspension of 10 business days to three months. Enforcement encourages us to impose a suspension commensurate with the dollar amount of Brown's Lorax investments even though Brown did not sell away to customers. Because Brown did not solicit or sell to customers, did not cause customer loss or harm the firm, and was not motivated by the potential for monetary gain, we decline to treat Brown's misconduct in this case as commensurate with selling away for purposes of imposing a suspension.

[232] *See* Guidelines at 13.

[233] *See* Guidelines at 89.

[234] *See Dep't of Enforcement v. McGee*, No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *86-87 (NAC July 18, 2016) (applying Guidelines for recordkeeping violations and falsification of records for registered representative's false statements on firm compliance questionnaires) (citing *John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464, at *83 (Feb. 10, 2012) (applying Guidelines for recordkeeping violations for misstatements on firm compliance questionnaires), *aff'd*, Exchange Act Release No. 80314, 2017 SEC LEXIS 987 (Mar. 27, 2017).

[235] *See* Guidelines at 29.

[236] Guidelines at 13 (Principal Consideration No. 5), 15 (Principal Consideration No. 13).

investors without Merrill Lynch's knowledge.[237] Although there is no evidence that the firm's customers or the firm were harmed, both could have been, and the firm was powerless to prevent harm because it was unaware of customer involvement. Brown argued that, as of 2012, the firm was satisfied with Brown's resolution of the matter, which included dissolving Lorax and disclosing the underlying individual investments.

Brown argued that Enforcement included these allegations in the Complaint solely to increase sanctions. This argument has no merit. Merrill Lynch's satisfactory resolution of Brown's failure to fully and accurately disclose Lorax is "irrelevant to [FINRA's] independent determination that a violation has or has not occurred" and offers little mitigation here.[238]

2. Violations Related to Iron Smoke, The Clean Energy Companies, OncoPep, Sweetwater, and Drive Safe

We now turn to Brown's violations of FINRA Rules 2010 and 3270 related to Iron Smoke, The Clean Energy Companies, OncoPep, Sweetwater, and Drive Safe under causes one, two, and five. The Guidelines for outside business activities recommend a fine of $2,500 to $73,000 and a suspension of 10 business days to three months, or more if aggravating factors are present.[239] The Guidelines for misrepresentations and material omissions of fact recommend a fine of $2,500 to $73,000 and a suspension of 31 calendar days to two years for negligent misconduct and more for intentional or reckless misconduct.[240] The Guidelines for recordkeeping violations recommend a fine between $1,000 and $15,000 and a suspension in any or all capacities for up to three months. Where aggravating factors predominate, the Guidelines recommend a fine of $10,000 to $146,000 and a suspension of up to two years or a bar.[241]

We find it aggravating that the outside business activities (Iron Smoke) involved customers of the firm, although we acknowledge that Brown did not solicit or recommend that customers invest.[242] With respect to Iron Smoke, we consider it mitigating that Brown advised Merrill Lynch that he co-founded and invested in Iron Smoke. We also have considered Merrill Lynch's abrupt termination of Brown as a factor in assessing sanctions. The Guidelines advise that adjudicators should acknowledge firms that address an individual's misconduct by taking corrective action, including termination.[243] In such cases, the "respondent has the burden to prove that a firm's termination of the respondent's employment has materially reduced the

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[237] Guidelines at 13 (Principal Consideration No. 1).

[238] *Dep't of Enforcement v. Merhi*, No. E072004044201, 2007 NASD Discip. LEXIS 9, at *27 (NAC Feb. 16, 2007).

[239] *See* Guidelines at 13.

[240] *See* Guidelines at 89.

[241] *See* Guidelines at 29.

[242] Guidelines at 13 (Principal Consideration No. 1).

[243] Guidelines at 5 (General Principles Applicable to All Sanction Determinations No. 7).

likelihood of misconduct in the future."[244] Brown candidly admitted at the hearing that his attitude towards Merrill Lynch's disclosure requirements was arrogant and cavalier, and he had not appreciated the importance of full compliance. He testified that he now understands the importance of compliance. We find Brown's testimony credible, and we factored Merrill Lynch's termination into our sanctions determination.

Enforcement asks us to find it aggravating that Brown has not accepted responsibility for his misconduct and has attempted to shift blame to Merrill Lynch management. We reject this argument. We do not find that Brown attempted to blame management for his rule violations. Rather, he sought to place his violative conduct into the proper context. As a respondent in a FINRA disciplinary action, Brown was "entitled under FINRA's rules to fully defend himself against the allegations of the complaint."[245] Brown admitted his misconduct and admitted he failed to appreciate the importance of Merrill Lynch's compliance structure. He states that, as a large producer, management had overlooked inadequate disclosures in the past and he wrongly assumed that he could continue in this manner. We do not accept this as a defense or as mitigative of sanctions. But we also do not find Brown's efforts to defend himself, coupled with his repeated admissions, as proof that he has not accepted responsibility for his actions.[246] Furthermore, we credit Brown's candor in admitting his disclosure failures.[247]

The Principal Considerations applicable to all violations are also instructive.[248] Many of the principal considerations are not applicable here in that Brown has no disciplinary history, there is no customer harm, Merrill Lynch did not suffer a loss, and Brown was not motivated by the possibility of remuneration or monetary benefit.[249] We find it aggravating that, after Merrill Lynch alerted Brown to his disclosure lapses related to Lorax, he did not improve his disclosure compliance and repeated past mistakes.[250] Although, given the length of Brown's career, we do not see a pattern of misconduct, we have considered aggravating that, all told, his inadequate disclosures spanned a period of several years.[251] Finally, we have considered whether Brown

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[244] *Id.*

[245] *Dep't of Enforcement v. Bullock*, No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at *60 (NAC May 6, 2011).

[246] *See Clinger & Co., Inc.*, 51 S.E.C. 924, 926 (1993) ("Persons charged with violations are entitled to pursue the procedural and substantive remedies provided by [FINRA].").

[247] *See Michael Earl McCune*, Exchange Act Release No. 77375, 2016 SEC LEXIS 1026, at *32 (Mar. 15, 2016) (crediting with respect to sanctions respondent's admission that he failed to timely amend his Form U4 and that his past attitude towards compliance "was not what it should have been"); *Dante J. DiFrancesco*, Exchange Act Release No. 66113, 2012 SEC LEXIS 54, at *34 (Jan. 6, 2012) (upholding FINRA's giving "some measure of mitigation" to fact that respondent was forthcoming in admitting throughout FINRA's proceedings that he improperly downloaded confidential customer information).

[248] *See* Guidelines at 7-8.

[249] *See* Guidelines at 7-8 (Principal Considerations Nos. 1, 11, 16).

[250] *See* Guidelines at 8 (Principal Consideration No. 14).

[251] *See* Guidelines at 7 (Principal Considerations Nos. 8, 9).

attempted to conceal his misconduct from his firm.[252] We find under cause two that Brown should have been more forthcoming with the explanations that he provided to Merrill Lynch in July 2014.[253] Brown states that he intended to use the July 2014 email as a starting point for further discussion. Regardless of his intention, we fault Brown for failing to follow through with Page to ensure that his responses were accurate. We therefore find this aggravating.

In sum, we suspend Brown from associating with any member firm in any capacity for nine months and fine him $125,000. As stated above, we have batched Brown's violations, and impose these sanctions as follows: a three-month suspension in all capacities and $25,000 fine for Lorax-related violations; and a six-month suspension in all capacities and $100,000 fine for violations related to Iron Smoke, The Clean Energy Companies, OncoPep, Sweetwater, and Drive Safe.

B. Goetz

Goetz violated FINRA Rule 2010 and NASD Rule 3040 by engaging in five outside investments without requesting or receiving prior approval. For these violations we suspend Goetz from associating with any member firm in any capacity for one month and fine him $25,000.

The Guidelines for private securities transactions recommend a fine of $5,000 to $73,000 and a range of suspensions based on the dollar amount of a respondent's sales away from the firm.[254] Most of the principal considerations specific to private securities transactions do not apply to sales to customers and therefore do not apply here.

As with Brown, we have considered Merrill Lynch's abrupt termination of Goetz as a factor in assessing sanctions.[255] Goetz candidly admitted his failures to disclose at the hearing and stated he did not appreciate the importance of full compliance with a firm's disclosure rules. He testified that he now understands the importance of compliance. We find Goetz's testimony credible, and we factored Merrill Lynch's termination into our sanctions determination. Furthermore, we credit Goetz's candor in admitting his misconduct.[256] Many of the principal considerations are not applicable here in that Goetz has no disciplinary history, there is no

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[252] *See* Guidelines at 7 (Principal Consideration No. 10).

[253] *See* CX-27. We dismiss the allegation in cause two that Brown was not forthcoming when questioned by the firm about Lorax.

[254] *See* Guidelines at 14. The Guidelines recommend that the adjudicator impose a suspension based on the dollar amount of sales away to customers. Enforcement encourages us to impose a suspension commensurate with the dollar amount of Goetz's outside investments. We decline to treat Goetz's misconduct in this case as commensurate with selling away to customers.

[255] *See* Guidelines at 5 (General Principles Applicable to All Sanction Determinations No. 7) (stating that adjudicators should acknowledge firms that address an individual's misconduct by taking corrective action, including termination).

[256] *See McCune*, 2016 SEC LEXIS 1026, at *32; *DiFancesco*, 2012 SEC LEXIS 54, at *34.

customer harm, Merrill Lynch did not suffer a loss, and Goetz is not a recidivist.[257] We find it aggravating, however, that firm customers also invested in the private companies in which Goetz invested and, had he properly disclosed his outside investments in the AIM system, he would have been prompted to research and disclose customers' investments as well. Merrill Lynch may have declined Goetz's requests to invest because firm customers were invested. We also find aggravating that Goetz may have been motivated to conceal his outside investments by his desire to avoid firm scrutiny.[258]

In light of these factors, we suspend Goetz from associating with any member firm in any capacity for one month and fine him $25,000.[259]

VI. Order

Under cause one, we find that Brown violated FINRA Rule 2010 by failing to disclose, in compliance disclosures and in response to firm inquiries, the full scope of his participation in outside businesses, customers' involvement with or investment in outside businesses, and the expansion of his involvement in investments away from the firm. Under cause two, we find that Brown violated FINRA Rule 2010 by misrepresenting and omitting facts during Merrill Lynch's internal investigation. Under cause two, we dismiss allegations related to Lorax. Under cause three, we find that Brown violated FINRA Rule 2010 and NASD Rule 3040 by participating in a material expansion of Lorax without amending his original disclosure. Under cause four, we find that Brown violated FINRA Rules 2010 and 3270 and NASD Rule 3030 by actively engaging in the business of managing Lorax without disclosing it as an outside business activity. Under cause five, we find that Brown violated FINRA Rules 2010 and 3270 by failing to disclose Iron Smoke as an outside business activity. We dismiss the allegations against Brown under cause six.

Under cause seven, we find that Goetz violated FINRA Rule 2010 and NASD Rule 3040 by investing in five private companies without providing prior written notice to, and receiving prior written permission from, Merrill Lynch.

For these violations, we fine Brown $125,000 and suspend him from associating with any member firm in any capacity for nine months. We fine Goetz $25,000 and suspend him from associating with any member firm in any capacity for one month. We also order Respondents, jointly and severally, to pay costs of $13,190.88, which includes a $750 administrative fee.

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[257] *See* Guidelines at 7 (Principal Considerations Nos. 1, 8, 9, 11).

[258] *See* Guidelines at 7 (Principal Consideration No. 10).

[259] We considered and rejected without discussion all other arguments by the parties.

If this decision becomes FINRA's final disciplinary action, the suspensions shall become effective with the opening of business on October 2, 2017. The fines and costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.

Carla Carloni
Hearing Officer
For the Extended Hearing Panel

Copies: Stephen Brown (*by first-class mail and overnight courier*)
James Goetz (*by first-class mail and overnight courier*)
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