

**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

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Stephen Brown and James Goetz were partners in the Brown Group, a registered investment advisory firm, and former registered representatives of Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch" or "the Firm").

2. From approximately 2009 through 2014, Brown participated in private securities transactions and engaged in an outside business activity after providing incomplete or inaccurate disclosures to Merrill Lynch.

3. The Firm's policies and procedures prohibited its registered representatives from participating in private securities transactions involving investments in entities in which customers also had invested and from engaging in outside business activities that involved Firm customers in any capacity.

4. To circumvent these prohibitions, Brown made false statements and failed to disclose material facts in his compliance disclosures relating to: (a) his founding of and

management role in a whiskey distillery called Iron Smoke; (b) Merrill Lynch customers' investments in Iron Smoke; (c) the scope of an investment pool he managed called Lorax; (d) Merrill Lynch customers' investments in Lorax; (e) Merrill Lynch customers' investments in several private companies in which Brown had also invested; and (f) Merrill Lynch customers' roles as principals or directors in the multiple private companies in which Brown had invested.

5. Brown's deception continued during a 2014 internal investigation into his disclosures, as he again provided false responses to Merrill Lynch management and outside counsel regarding his private securities transactions and outside business activities. Brown also denied knowing what companies his customers had invested in away from Merrill Lynch when, in truth, he was acutely aware of these investments and maintained spreadsheets to track them.

6. By providing false responses to Merrill Lynch in disclosure documents and during its internal investigation, Brown violated FINRA Rule 2010.

7. In addition, Brown disclosed Lorax to Merrill Lynch as an investment vehicle whereby only he and his siblings would pool funds to invest in a single private company, and Merrill Lynch approved his participation based on that representation. However, without any further disclosure or clarification to the Firm, Brown subsequently participated in the material expansion of Lorax's investor base by facilitating investments into Lorax by several non-family members, including more than a dozen Merrill Lynch customers. He also participated in the material expansion of Lorax's investment portfolio by causing Lorax to invest in three additional private companies.

8. By failing to disclose to the Firm that he had materially expanded Lorax into an investment pool that included non-family members, including Merrill Lynch customers, and that

he had expanded Lorax's portfolio by investing in additional private companies, Brown violated FINRA Rules 3040 and 2010.

9. Similarly, Brown failed to properly disclose that he was operating Lorax as an outside business activity. Brown facilitated the above-described family and customer investments into Lorax as well as Lorax's investments into several private companies. He also maintained Lorax's records, made its distributions, and subsequently handled its dissolution.

10. By failing to disclose that he was running Lorax as an outside business activity, particularly one that included Merrill Lynch customers, Brown violated NASD Rule 3030 and FINRA Rules 3270 and 2010.¹

11. Moreover, when Brown disclosed Iron Smoke to Merrill Lynch, he represented that it was only a passive investment involving no firm customers. In truth, Brown was one of Iron Smoke's three founding members, he handled its finances, and he maintained voting rights. In addition, a Merrill Lynch customer was one of the other co-founders and the largest investor, and several follow-on investors were also firm customers.

12. By failing to disclose Iron Smoke as an outside business activity and failing to disclose that customers were co-investors, Brown violated FINRA Rules 3270 and 2010.

13. In July 2013, a Brown Group client associate informed Brown that a customer's check request had been flagged by the firm's Office of Foreign Asset Control ("OFAC") system and thus could not be processed. Brown directed the client associate to misspell the payee's name on the check request and to resubmit it. The second check request, as altered, was not flagged by the firm's OFAC system and the request was processed and the check issued.

14. By directing the client associate to alter the check request to circumvent Merrill Lynch's compliance systems, Brown violated FINRA Rule 2010.

¹ NASD Rule 3030 was superseded by FINRA Rule 3270 effective December 15, 2010.

15. Goetz invested in at least five of the same private companies in which Brown had invested without making the required disclosures to or receiving authorization from Merrill Lynch. In fact, Goetz verbally sought approval to invest in Iron Smoke, was expressly instructed by Merrill Lynch management not to do so, but made the investment anyway.

16. By failing to disclose private securities transactions, Goetz violated NASD Rule 3040 and FINRA Rule 2010.

RESPONDENTS AND JURISDICTION

17. Brown first became associated with a FINRA member firm in 1987. He was registered with Merrill Lynch as a General Securities Representative from September 1991 to September 2014. Merrill Lynch terminated Brown's registration on September 19, 2014, for "conduct related to not disclosing outside business activities and participation in private securities transactions involving clients." He is currently associated with FINRA member Stifel, Nicolaus & Company, Inc.

18. Goetz first became associated with a FINRA member firm in 1996. He was registered with Merrill Lynch as a General Securities Representative from October 1997 to September 2014. Merrill Lynch terminated Goetz's registration on September 19, 2014, for "conduct related to not disclosing private securities transactions, including transactions alongside clients, and not being forthcoming during an internal review." He is currently associated with FINRA member Stifel, Nicolaus & Company, Inc.

FACTS

Merrill Lynch's disclosure requirements

19. The Brown Group became part of Merrill Lynch's Private Banking and Investment Group ("PBIG") in 2001. Brown and Goetz, who became partners in 1997, were

Brown Group's only producing registered representatives. Together they managed approximately \$2.5 billion for high-net-worth families and corporate 401(k) plans out of Merrill Lynch's Pittsford, New York office, which is located just outside Rochester. Brown was the primary business-generator and tended to service the group's larger individual and corporate clients. As a condition to membership in PBIG, Brown and Goetz were limited to a maximum of 100 client relationships, with each client holding a minimum of \$2.5 million at Merrill Lynch.

20. Merrill Lynch required registered representatives to disclose private securities transactions and outside business activities through an online system and to receive authorization before participating in the relevant investment or engaging in the relevant activity. The Firm's policies and procedures prohibited "joint investment with any client or in a client's business" and private securities transactions were allowed only if "the Employee's clients are not investing in the entity" and "the private security was not brought to the attention of the Employee by a client." As for outside business activities, the Firm's policies and procedures stated that "Firm clients must not be involved in the business interest in any capacity." Brown and Goetz acknowledged in annual compliance certifications that they were familiar with and understood the Firm's policies and procedures.

21. Because of these prohibitions on investing alongside customers or in entities in which customers were involved, Merrill Lynch registered representatives were required to disclose any such customer involvement in private securities transactions or outside business activities. If customer investment or involvement was disclosed, then the investment or activity would automatically be denied. The registered representative would then be required to seek an exception and receive express authorization to proceed with the investment or activity.

Lorax LLC

22. Brown formed Lorax LLC (“Lorax”) in or around early 2008 to pool funds with his siblings to invest in a single private company, Company CL, because they did not want to make the minimum required investment individually.

23. On January 17, 2008, Brown sought approval to participate in Lorax and disclosed to Merrill Lynch that the investors would be himself and his siblings and that Lorax’s sole purpose was to invest in Company CL. Based on that disclosure, Brown’s participation in Lorax was approved.

24. Brown completely ran the business of Lorax, such as by facilitating its investments, keeping its records, reporting and making distributions, and eventually dissolving the company. Merrill Lynch understood that Brown was running Lorax in this manner, but its approval of his participation was limited to the parameters that he had disclosed, *i.e.*, that the only investors in Lorax were himself and his siblings and that Lorax’s investments were limited to one private company.

25. Subsequent to Brown’s January 2008 disclosure but prior to discovery by the Firm, Brown participated in the material expansion of Lorax’s investor base by facilitating investments from non-family member investors, including more than a dozen Merrill Lynch customers, totaling over \$1.3 million.²

26. Brown did not amend or clarify his disclosure or seek permission from Merrill Lynch to involve these additional investors—and Firm customers—in Lorax.

27. Likewise, subsequent to Brown’s January 2008 disclosure but prior to the Firm’s discovery, Brown caused Lorax to invest in three additional private companies—Company FC,

² The additional investors were ML customers RS, CB, RBi, RBr, PG, CW, WT, RR, SW, JG, SW, CR, TF, RK, and AM.

Company WS, and Company CE— in addition to the single company he had identified in his initial disclosure to the Firm.

28. Brown did not amend his disclosure or seek permission from Merrill Lynch to include these additional investments by Lorax.

29. In late 2010 or early 2011, Goetz attempted to invest in Lorax by writing a check to Lorax from an account he held at Merrill Lynch, but his check was flagged by the Firm's compliance department.

30. In the course of investigating Goetz's check, Merrill Lynch questioned Goetz about the nature of his Lorax investment. In response, Goetz falsely represented to local Merrill Lynch management that the money was intended for a real estate investment and that "Lorax" was the name of the property he was investing in.

31. When Merrill Lynch management later confronted Goetz with the fact that Brown had previously disclosed Lorax as a family investment vehicle, Goetz changed his story and admitted that he was investing in Brown's investment vehicle.

32. Also, as part of this review, Merrill Lynch management told Brown that he would need to disclose Goetz's investment in Lorax. The Firm also required Brown to disclose whether anyone else had invested in Lorax beyond him and his siblings.

33. In response to this inquiry, Brown disclosed for the first time that non-family members had invested in Lorax and that Lorax had invested in the three additional private companies.

34. At the conclusion of its review, in or about March 2012, Merrill Lynch warned Brown and Goetz that they were expected to follow the policies and procedures prohibiting joint investment with a client and investments in a client's business.

Iron Smoke Whiskey

35. In late 2011, Brown co-founded Iron Smoke Whiskey LLC (“Iron Smoke”) along with his friend TB, who came up with the concept, and Merrill Lynch customer RK, who invested \$300,000.

36. Brown handled Iron Smoke’s finances, including paying its bills and maintaining its bank account. Brown also maintained voting rights in Iron Smoke.

37. Brown disclosed his participation in Iron Smoke to Merrill Lynch on July 5, 2012, but only as a private securities transaction with a passive investment of \$75,000, not as an outside business activity. In response to specific inquiries from management prior to approval of his participation, Brown falsely represented that he had no duties with the company and that no customers were investors. Brown’s participation was approved based on these disclosures.

38. Subsequent to Brown’s initial disclosure, investments in Iron Smoke from investors other than the co-founders totaled at least \$600,000 and included both Merrill Lynch customers and non-customers.³ Brown was aware of these investments and maintained records to track these investments.

39. Brown did not amend his Firm disclosure concerning Iron Smoke to reflect this customer participation or otherwise seek permission from Merrill Lynch to continue his investment alongside customers. Likewise, Brown did not disclose—in his initial disclosure or thereafter—that he was actively engaged in Iron Smoke’s business. In fact, on August 21, 2013, when disclosing and seeking approval to make an additional investment in Iron Smoke, Brown falsely stated that he “still [had] no duties with the company.”

³ The additional investors were ML customers RS, CB, RBr, WT, MP, RM, KW, and AM and non-customers MK and SS.

40. In February 2014, Merrill Lynch's compliance systems flagged a Brown Group customer's wire transfer request from a Merrill Lynch account to Iron Smoke's bank account because wire transfers from five other customers had gone to the same third-party bank account.

41. Thereafter, the firm conducted an investigation of the wire transfer request. During this investigation, Brown admitted for the first time that Merrill Lynch customers were investors in Iron Smoke and that he had an active role in the company.

42. As a result, Merrill Lynch forced Brown to give up his duties involving the company's finances and his voting rights.

43. Later in 2014, Goetz verbally sought permission from a Firm supervisor, WP, to invest in Iron Smoke.

44. In response, WP told Goetz that he could not make the investment because of the recently-discovered customer investments in Iron Smoke.

45. Goetz nevertheless invested \$25,000 in Iron Smoke in May or June 2014, despite WP's instruction not to do so.

Brown's and Goetz's Energy Program Investments

46. In or about 2008, a Merrill Lynch and Brown Group customer, AC, donated a large sum of money to the Massachusetts Institute of Technology's alternative energy program ("Energy Program").

47. Several private start-up companies emerged from the Energy Program and AC served as a mentor to the founders of at least four of those companies—Company G, Company U, Company FS,⁴ and Company FC. In addition, AC served as lead investor for Customer FC and was a board member for Company U and Company FS.

⁴ Company FS was also one of the companies invested in by Lorax.

48. AC and more than a dozen other Firm customers variously invested in the four Energy Program companies: over \$1.5 million in Company FC,⁵ \$425,000 in Company U,⁶ \$530,000 in Company G,⁷ and \$275,000 in Company FS.⁸ Brown was aware of these investments and maintained records to track them.

49. Subsequent to AC's investments in and involvement with the four Energy Program companies, Brown invested \$100,000 in Company FC, \$50,000 in Company G, \$50,000 in Company U, and \$50,000 in Company FS. Brown knew that AC was an investor in and mentor for these four Energy Program companies prior to making his investments.

50. Brown disclosed his investments in Company FS and Company U on March 25, 2013, and his investments in Company G and Company FC on October 3, 2013. Brown's participation was approved based on these disclosures. However, he failed to disclose that customers were also investors and that customers were principals or directors of the companies.

51. Also, in multiple instances, he affirmatively misrepresented that customers were *not* involved even though he knew they were investors or principals:

- (i) in disclosing his investment in Company G, Brown affirmatively stated that no customers were involved, which was not true because Brown knew that multiple Merrill Lynch customers had invested in Company G;
- (ii) in disclosing his investment in Company U, Brown affirmatively stated that no customers had invested in the company or were otherwise involved, which was not true because Brown knew that multiple Merrill Lynch customers had invested in Company U and that AC served on the board of directors; and
- (iii) in disclosing his investment in Company FS, Brown affirmatively stated that no customers had invested in the company or were otherwise

⁵ The Merrill Lynch customer investors in Company FC were AC, RS, CB, RBi, RBr, WT, JG, CR, TF, MB, MP, RM, AI, and AL.

⁶ The Merrill Lynch customer investors in Company U were AC, JG, WT, MP, KW, JB, RG, and JF.

⁷ The Merrill Lynch customer investors in Company G were RS, CB, RBi, RBr, WT, JG, CR, RK, MB, MP, RM, and AL.

⁸ The Merrill Lynch customer investors in Company FS were RS, CB, RBr, WT, JG, CF, TF, MB, MP, RM, and AL.

involved, which was not true because Brown knew that multiple Merrill Lynch customers had invested in Company FS and that AC served on the board of directors.

52. Subsequent to Brown's and many of the Merrill Lynch customers' investments, Goetz also invested in the four Energy Program companies.

53. Goetz invested \$25,000 each in Company FC, Company U, and Company FS after attending an event in Rochester hosted by AC in approximately July 2012 where principals of those companies and AC spoke.

54. He later invested \$10,000 in Company G.

55. Goetz did not disclose any of these investments to Merrill Lynch.

Brown's additional private investments

56. Brown invested in three additional private companies—Company SW, Company DS, and Company OP—in which customers were investors and principals or directors.

57. Brown invested \$50,000 in Company SW, a bioenergy company, in or around February 2010.

58. AC and other Merrill Lynch customers invested \$795,000 in Company SW.⁹ Brown was aware of these investments and maintained records to track these investments.

59. AC was a board member of Company SW and later became its CEO.

60. Brown disclosed his investment in Company SW on February 19, 2010.

However, he did not disclose the customer involvement in Company SW. In fact, he represented that, prior to learning of the investment opportunity, he had not had contact with persons associated with the entity (including co-investors, other shareholders, officers, or directors) who had an account with Merrill Lynch. Brown's participation was approved based on this disclosure.

⁹ Merrill Lynch customer investors in Company SW were AC, WT, CR, TF, MB, MP, and RM.

61. Brown's disclosure was false, however, because Brown knew that AC was a director and shareholder of Company SW at the time Brown made his investment.

62. Brown invested \$50,000 in Company DS, a technology company developing software relating to text messaging, in or around November 2011.

63. AC and several other Merrill Lynch customers invested \$1,480,000 in Company DS.¹⁰ Brown was aware of these investments and maintained records to track these investments.

64. AC founded Company DS and was its largest investor.

65. Brown disclosed his investment in Company DS on November 23, 2011.

However, he did not disclose the customer involvement in Company DS. In fact, he represented that no customers were involved with Company DS. Brown's participation was approved based on this disclosure.

66. Brown's disclosure was false, however, because Brown knew that AC founded Company DS and was its largest investor.

67. Brown invested \$60,000 in Company OP, a vaccine development company, in or around February 2011.

68. Several Merrill Lynch customers invested at least \$32,000 in Company OP.¹¹ Brown was aware of these investments and maintained records to track these investments.

69. In addition, Brown Group customer EP was a board member of Company OP. Brown knew this and, in fact, EP had introduced Brown to Company OP.

70. Brown disclosed his investment in Company OP on February 1, 2011. However, Brown did not disclose the customer involvement in Company OP. In fact, he represented that

¹⁰ The Merrill Lynch customer investors in Company DS were AC, MP, KW, SS, and EJB.

¹¹ The Merrill Lynch customer investors in Company OP were RS, CB, RBr, and AM.

no customers were investors or otherwise involved with Company OP. Brown's participation was approved based on this disclosure.

71. Brown's disclosure was false, however, because Brown knew that EP was a board member of Company OP and that multiple Firm customers were investors in Company OP.

Brown intentionally evaded Merrill Lynch's OFAC Compliance System

72. In July 2013, customer DP requested a check drawn from his Merrill Lynch account for the purchase of a motorcycle. AS, a Brown Group client associate, processed the check request.

73. Merrill Lynch subjects check requests to a review for the Specially Designated Nationals and Blocked Persons list maintained by OFAC. The check request for DP was flagged by Merrill Lynch's OFAC compliance system because the payee's name, JR, appeared on the OFAC list.

74. The check request was denied and AS was notified by WP that she would need to provide additional information regarding JR before the check could be issued. AS therefore asked Brown what she should do because the customer was coming to the office to pick up the check.

75. Rather than obtain the additional information required by Firm compliance, Brown directed AS to submit a new check request with the payee's name slightly misspelled, thereby allowing the new check request to circumvent the firm's OFAC system.

76. AS did as Brown directed and the new check request, as altered, was successfully processed and the check was issued and negotiated.

Merrill Lynch's Internal Investigation

77. Following Merrill Lynch's discovery that Brown had falsely misrepresented whether customers were participating in Iron Smoke, as alleged above, Merrill Lynch conducted an internal investigation into Brown's and Goetz's disclosures.

78. As part of this investigation, WP sought statements from Brown and Brown was interviewed by outside counsel.

79. Brown stated during the firm's internal investigation that he was unaware of whether customers had invested in particular private companies away from Merrill Lynch.

80. That statement was false, and the Brown Group contemporaneously maintained spreadsheets that tracked each customer's investment in each private company.

81. Likewise, as part of Merrill Lynch's internal investigation, WP sent an email to Brown in which WP collected the investments Brown had disclosed and requested that Brown state the nature of the investment and whether customers were involved. In his response, Brown denied that customers were involved in the companies in which he invested, which he knew was not true.

82. Merrill Lynch terminated Brown and Goetz at the conclusion of its internal investigation in September 2014.

FIRST CAUSE OF ACTION Providing False Responses to his Member Firm (FINRA Rule 2010) (Brown)

83. The Department realleges and incorporates by reference paragraphs 1 through 82 above.

84. FINRA Rule 2010 states that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

85. It is a violation of FINRA Rule 2010 for registered persons to make false representations or to fail to make required disclosures to their member firm.

86. When disclosing and seeking authorization for private securities transactions and outside business activities, Merrill Lynch registered representatives were required to disclose if customers were investors in or otherwise involved with the entity.

87. As alleged above, Brown failed to disclose in compliance disclosures and in response to inquiries from firm compliance relating to his private investments: (i) the full scope of his participation in the business of Lorax and Iron Smoke; (ii) that customers AC, EP, RS, CB, RBi, RBr, PG, CW, WT, RR, SW, JG, SW, CR, TF, RK, AM, MP, RM, KW, MB, AI, AL, JB, RG, JF, CF, SS, and EJB were also investors in the private companies in which he invested; and (iii) that customers AC and EP were principals or directors of the private companies in which he invested.

88. Also, as alleged above, Brown falsely represented in compliance disclosures and in response to inquiries from firm compliance personnel relating to his private investments that his participation in the investment was passive, that customers were not also investors, and that customers were not principals or directors of the private companies in which he invested.

Brown:

- (i) falsely stated in an investment disclosure form and in response to inquiries from the Firm that he had no duties with Iron Smoke and that no customers had invested in or were otherwise involved with Iron Smoke;
- (ii) falsely stated in an investment disclosure form and in response to inquiries from firm compliance that no customers were involved in Company G;
- (iii) falsely stated in an investment disclosure form and in response to inquiries from firm compliance that no customers had invested in or were otherwise involved with Company U;

- (iv) falsely stated in an investment disclosure form and in response to inquiries from firm compliance that no customers had invested in or were otherwise involved with Company FS;
- (v) falsely stated in an investment disclosure form and in response to inquiries from firm compliance that there was no customer involvement in Company SW and that he had no contact with persons associated with Company SW when he made his investment;
- (vi) falsely stated in an investment disclosure form and in response to inquiries from firm compliance that no customers were involved with Company DS; and
- (vii) falsely stated in an investment disclosure form and in response to inquiries from firm compliance that no customers were involved with Company OP.

89. Moreover, as alleged above, Brown failed to disclose that he participated in investments in Lorax by people other than his siblings, including Merrill Lynch customers, and that he participated in investments by Lorax into three additional private companies.

90. As a result of the foregoing misconduct, Brown violated FINRA Rule 2010.

SECOND CAUSE OF ACTION
Providing False Responses to his Member Firm During an Internal Investigation
(FINRA Rule 2010)
(Brown)

91. The Department realleges and incorporates by reference paragraphs 1 through 90 above.

92. During the firm's internal investigation into his disclosures, Brown failed to disclose that customers were investors in and principals or directors of the private companies in which he invested.

93. Moreover, Brown falsely represented during the firm's internal investigation that customers were not investors in and were not principals or directors of the private companies in which he invested.

94. Brown also falsely stated during the firm's internal investigation that he was not aware of his customers' investments in multiple private companies when, in fact, Brown was aware of those investments and maintained records tracking those investments.

95. As a result of the foregoing misconduct, Brown violated FINRA Rule 2010.

**THIRD CAUSE OF ACTION
Private Securities Transactions
(NASD Rule 3040 and FINRA Rule 2010)
(Brown)**

96. The Department realleges and incorporates by reference paragraphs 1 through 95 above.

97. NASD Rule 3040 provided that "[n]o person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this rule. Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice."

98. Brown disclosed to his member firm that he was investing in Lorax but stated that Lorax's investors included only his family members and that Lorax was investing in only one private company. Merrill Lynch's approval of his participation in this private securities transaction was limited to the parameters of this disclosure.

99. Subsequent to the disclosure, Brown participated in the material expansion of Lorax by facilitating investments into Lorax by additional investors outside of his family, including Merrill Lynch customers.

100. Also, subsequent to his disclosure, Brown actively participated in Lorax's investments in three additional private companies beyond the one he had disclosed to the Firm.

101. Brown did not amend his disclosure or otherwise request permission to participate in private securities transactions related to Lorax to include either his participation in the non-family member and customer investments or his participation in Lorax's investments in the three additional private companies.

102. Brown participated in the investments in Lorax by facilitating the investments as alleged above and by keeping records of the investments, reporting and making distributions, and eventually dissolving the company.

103. Brown participated in the investments made by Lorax by facilitating those investments, keeping records of those investments, and distributing those investments to individual investors when Lorax was dissolved.

104. The customers invested money in Lorax with the expectation that they would receive profits derived from the effort of others. Lorax invested money in Company CL, Company FC, Company WS, and Company CE with the expectation that it would receive profits derived from the effort of others.

105. Brown failed to give prior written notice to, and receive prior written permission from, his employer firm before participating in the private securities transactions involving non-family member investments in Lorax and Lorax's investments into three additional, undisclosed private companies.

106. As a result of the foregoing misconduct, Brown violated NASD Rule 3040 and FINRA Rule 2010.

**Fourth Cause of Action
Outside Business Activities Related to Lorax
(NASD Rule 3030 and FINRA Rules 3270 and 2010)
(Brown)**

107. The Department realleges and incorporates by reference paragraphs 1 through 106 above.

108. NASD Rule 3030 provided 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 as a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member.” FINRA Rule 3270, which superseded NASD Rule 3030 effective December 15, 2010, provides that “no registered person may be an employee, independent contractor, sole proprietor, officer, director or partners of another person, or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member.”

109. Brown actively engaged in the business of managing Lorax as an investment vehicle, including by handling its finances, facilitating its investments, reporting to investors, and making distributions upon its dissolution.

110. Brown disclosed his engagement with Lorax only as an investment vehicle for himself and family members to invest in one private company. Merrill Lynch’s approval of Brown’s engagement with Lorax was based on the parameters of this disclosure.

111. That disclosure became materially false when non-family members, including Merrill Lynch customers, invested in Lorax.

112. That disclosure also became materially false when Lorax invested in three additional private companies.

113. Brown failed to amend his disclosure to accurately reflect the nature of Lorax and his engagement therein and failed to seek permission to operate Lorax as an investment pool for non-family members, including Merrill Lynch customers, and to invest in multiple private companies.

114. As a result of the foregoing misconduct, Brown violated NASD Rule 3030 and FINRA Rules 3270 and 2010.

**Fifth Cause of Action
Outside Business Activities Related to Iron Smoke
(FINRA Rules 3270 and 2010)
(Brown)**

115. The Department realleges and incorporates by reference paragraphs 1 through 114 above.

116. Brown engaged in the business of Iron Smoke outside the scope of his relationship with his member firm, including by handling its finances and holding voting rights.

117. Brown disclosed his participation in Iron Smoke as a private securities transaction but failed to disclose it as an outside business activity, even though he was actively engaged in Iron Smoke's business and Merrill Lynch customers were also investors in Iron Smoke. Merrill Lynch approved Brown's participation in Iron Smoke only as a passive investment that did not involve firm customers. The firm did not approve Brown's engagement in Iron Smoke as an outside business activity.

118. As a result of the foregoing misconduct, Brown violated FINRA Rules 3270 and 2010.

**Sixth Cause of Action
Directing an Associated Person to Alter a Document to Evade OFAC Review
(FINRA Rule 2010)
(Brown)**

119. The Department realleges and incorporates by reference paragraphs 1 through 118 above.

120. Taking steps to circumvent a firm's compliance systems is inconsistent with high standards of commercial honor and just and equitable principles of trade.

121. Brown directed Brown Group client associate AS to alter the name of the payee on a check request with the intent to circumvent Merrill Lynch's OFAC compliance systems.

122. As a result of the foregoing misconduct, Brown violated FINRA Rule 2010.

**Seventh Cause of Action
Private Securities Transactions
(NASD Rule 3040 and FINRA Rule 2010)
(Goetz)**

123. The Department realleges and incorporates by reference paragraphs 1 through 122 above.

124. Goetz invested in five private companies—Iron Smoke, Company FC, Company U, Company FS, and Company G.

125. Goetz verbally sought authorization to invest in Iron Smoke, was expressly told that he was not authorized to make the investment because customers were investors in Iron Smoke, but then made the investment despite the denial of his request.

126. All of the foregoing investments were private securities transactions.

127. Goetz failed to give prior written notice to, and receive prior written permission from, his employer firm before participating in these private securities transactions.

128. As a result of the foregoing misconduct, Goetz violated NASD Rule 3040 and FINRA Rule 2010.

RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that Brown and Goetz committed the violations charged and alleged herein;
- B. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed; and
- C. order that Brown and Goetz bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.

FINRA DEPARTMENT OF ENFORCEMENT

Date: April 1, 2016

Respectfully submitted,



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