

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING  
FILE NO. 3-13871

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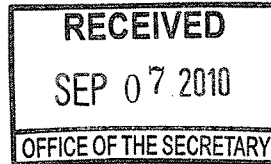
In the Matter of

RONALD S. BLOOMFIELD  
ROBERT GORGIA  
VICTOR LABI  
JOHN EARL MARTIN, SR., and  
EUGENE MILLER

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CHIEF JUDGE  
BRENDA P. MURRAY



PRE-HEARING BRIEF OF DIVISION OF ENFORCEMENT

September 3, 2010

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The Division of Enforcement respectfully submits this Pre-Hearing Brief.

### **PRELIMINARY STATEMENT**

Low-priced securities (or “penny stocks”) generally require vigilance from compliance professionals at broker-dealers. But a particular type of penny stock trading requiring even greater attention: trading by those who do not purchase their penny stocks on the market, but rather obtain them privately and then sell them to the public. Such activity raises significant compliance-related issues concerning how the customer obtained the stock; whether the customer is a promoter, or connected to the issuer in some way; and, if the shares have not been the subject of a registered public offering, whether the sale of privately-obtained stock to the public violate registration provisions.

From at least early 2005 until it closed shop in mid-2007, all of these concerns were magnified at Leeb, whose customers routinely delivered in large blocks of privately obtained penny stocks and sold them to the public. Not only did penny stock trading constitute a significant percentage of Leeb’s customer activity, but the shares sold by Leeb customers dwarfed penny stock purchases: while Leeb customers sold over 4 billion penny stock shares, they purchased only 693 million. Thus, in sheer quantity of activity, Leeb customer activity called for heightened attention.

In addition, the profile of Leeb’s customers raised additional red flags. One particularly large penny stock selling customer was incorporated in Nevis; operated by persons in Vancouver; had orders submitted by traders in Costa Rica; and wired tens of millions of dollars in penny stock sale proceeds to Liechtenstein. Another set of customer accounts were connected to an individual with a prior pump-and-dump consent judgment and a known promoter who was compensated by issuers for his services with

stock. Yet another customer actually sent instant messages to Respondent Victor Labi discussing upcoming news for an issuer whose stock he had deposited (and sold) at Leeb.

In the face of all of this activity, the Leeb respondents had three basic responsibilities: Respondents Bloomfield, Martin and Labi were required to conduct a “reasonable inquiry” into the stock being sold by their customers, to insure that they were not facilitating illegal underwriting in violation of Section 5 of the Securities Act.

Respondent Gorgia had a supervisory responsibility to ensure that a “reasonable inquiry” was in fact being conducted, to prevent any such violations. And all of the respondents had a responsibility to ensure that Leeb fulfilled its obligations under Exchange Act Rule 17a-8 to file Suspicious Activity Reports as required by the Bank Secrecy Act.

As discussed below, the respondents failed to meet these obligations—despite numerous inquiries from their clearing firm and from regulatory bodies concerning their customer activity.

## **STATEMENT OF FACTS**

### **Leeb’s Structure and Respondents’ Positions**

Leeb Brokerage Services, Inc. was a New York-incorporated broker-dealer with a main office in New York and an Office of Supervisory Jurisdiction (“OSJ”) in California. Leeb was registered with the Commission from March 1999 to July 20, 2007, when the firm filed a Broker-Dealer Withdrawal form (“BDW”).<sup>1</sup> Leeb’s former president was Respondent Gene Miller.<sup>2</sup> From February 2005 to July 2006, Respondent Gorgia was the

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<sup>1</sup> Although technically dissolved, it is believed to be insolvent.

<sup>2</sup> On August 20, 2010, the Commission issued an Order approving a settlement with Miller. See Lit. Rel. No. 62750 (Aug. 20, 2010).

firm's Chief Compliance Officer and the supervisor of the firm's Anti-Money Laundering ("AML") program.

Respondent Labi, whose business consisted primarily of customers who sold penny stocks, was situated in the New York office. Respondents Bloomfield and Martin, whose business also consisted primarily of customers who sold penny stocks, were situated in the OSJ, of which Bloomfield was the supervisor.

### **The Penny Stock Business**

In April 2005, when Gorgia was assisting Leeb obtain NASD approval to open its then-to-be new OSJ, Bloomfield sent Gorgia an email describing a group of his clients as "investment bankers who are not personally affiliated with any specific broker dealer," and explaining that the OSJ would "help these individuals manage the stocks in the companies that they provide funding and we help create the exit strategy for them to sell the stock that [sic] receive as compensation for funding these companies." At the same time, Leeb's clearing firm, Pershing, started repeatedly warning Gorgia of concerns over Leeb customers that were bringing in privately obtained stock and selling it to the public, which was also occurring with Labi's customers.

The evidence at trial will show that Pershing ultimately terminated its clearing relationship with Leeb because of its concerns with Leeb's lack of oversight of its penny stock customers. The evidence will also show that Leeb's penny stock business continued unabated, with penny stocks being a large component of Leeb's entire brokerage activity, with 75% of all sales transactions at Leeb priced at \$5.00 or less during the relevant period. Moreover, the 4.1 billion shares of penny stock shares sold

greatly exceeded the 693 million penny stock shares that were purchased. The disparity is caused by the large number of shares delivered in to Leeb customer accounts.

Among Bloomfield, Martin and Labi's penny stock customers who routinely delivered in shares and sold them to the public were the following accounts:

(1) The Useltons. Darrel and Jack Uselton were customers of Martin and Bloomfield. Both of them had regulatory histories, including Jack Martin having entered into a consent judgment in a pump-and-dump case that included charges of issuing false press releases.<sup>3</sup> They controlled a total of five separate LLC and LP accounts.

According to Bloomfield, four of the accounts were investment companies that purportedly invested in companies through private transactions in return for stock, and fifth account, in the name of OTC Services, Inc., was a stock promotion entity that was compensated in stock by its issuer clients.

(2) Thimble Capital Ltd. Thimble was also a Martin and Bloomfield customer. Thimble was incorporated in Nevis, operated out of Vancouver, Canada, and banked in Liechtenstein, where it wired over \$40 million in penny stock proceeds (often from stock sold coincident with spam campaigns). Under Leeb's AML program and incorporated sources, Nevis is listed as a jurisdiction of primary concern for money laundering that would support classifying an account originating from there as high risk. Likewise, Leeb's AML program states that wire transfers to bank secrecy jurisdictions and tax havens, such as Liechtenstein, constitute red flags.

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<sup>3</sup> SEC v. Christensen, Civ. No. H01-3203 (S.D. Tex.), Lit. Rel. No. 17787 (Oct. 16, 2002).

(3) Gerald Alexander. This Labi customer controlled two corporate accounts, each of which was nominally placed in the name of his daughter. He engaged in numerous instant messages with Labi concerning upcoming news and promotional campaigns in penny stocks, including ones that he was delivering in to sell.<sup>4</sup>

**Reasonable Inquiry**

As will be explained below, broker-dealers whose customers deliver in shares of stock that have not been subject to registered offerings must engage in a “reasonable inquiry” to insure against the facilitation of illegal underwriting. The evidence will show that Leeb engaged in a pattern of not conducting such inquiry, leading to the possibility of such illegal underwriting.

To assist Leeb in conducting such inquiry, Pershing provided Leeb with a “Low Priced Security Questionnaire” to be filled out in connection with the delivery in of penny stocks. Although that form would have assisted Bloomfield, Martin and Labi in conducting a “reasonable inquiry,” the evidence will show that Pershing had to repeatedly seek completion of the forms from the firm; that the questionnaires were not completed on a regular basis, or in a timely manner.

Nor is there any evidence that Bloomfield, Martin or Labi ever undertook a “reasonable” inquiry into how it was that its customers were obtaining so many shares of purportedly “free-trading” stock in private unregistered transactions. As an example, there is no evidence that they asked for subscription agreements or attorney opinion letters.

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<sup>4</sup> The evidence at trial will also pertain to other customers.

## **Unregistered Offerings and Suspicious Trading**

The evidence will show that Bloomfield, Martin and/or Labi participated in at least ten offerings of unregistered securities of the following issuers: Equipment and Systems Engineering, Inc.; Golden Apple Oil and Gas Inc. (f/k/a CDI Developments, Inc.); Lifeline Biotechnologies, Inc.; China Gold Corp.; Viyya Technologies, Inc.; Spooz Inc.; Goldmark Industries, Inc.; and LOM Logistics, Inc.; iPackets International, Inc.; and Adrenaline Nation Entertainment, Inc. No exemption from the registration requirement applies to any of these issuances.

In many instances, the registration violations were accompanied by suspicious market activity, or additional suspicious trading by the Leeb customer beyond the large sales of stock. A summary of some of the evidence concerning these stocks is as follows:

Equipment Systems and Engineering, Inc.: In October 2005, EQSE hired the Uselton entity OTC Services to provide consulting services. To compensate OTC Services, EQSE agreed to arrange for another shareholder to transfer 700,000 shares of purportedly unrestricted stock to OTC Services. OTC Services deposited the stock at Leeb in early November, when there had only been six trading days in EQSE since January 26, 2005. Prior to delivering in the shares, a different Uselton account at Leeb (Warrior Capital) purchased and sold small amounts of EQSE stock at a price of 15 cents per share. On the day after OTC Services delivered its stock, Warrior Capital purchased additional small amounts of shares at a price of 19 cents. The market rose from there and OTC Services sold out its 700,000 shares over the next three months.

In October 2006, another Uselton entity, Valores Fund LP, received 3.75 million shares in a private transaction, giving it control of over 24.5% of the purportedly free-

trading stock. It received the stock from two entities, consultants to EQSE, that had initially controlled virtually all of the EQSE stock that was not held by EQSE's president.

On October 25, 2006, Valores Fund deposited the shares into its account at Leeb. At that time, EQSE trading volumes were routinely under 10,000 shares. However, at the end of November, Valores Fund purchased and OTC Services sold 150,000 shares opposite each other at Leeb, helping to take trading volume from 1,000 shares on November 28 to 193,155 shares on November 29 and 415,000 shares on November 30. The next day, on December 1, 2006, a press release and spam email were circulated, and the Uselton accounts began selling their shares. By December 6, 2006, the trading price had risen to 17 cents per share on a daily volume of 3 million shares. In the week from December 1 through December 8, the Valores Fund and OTC Services accounts, together with an account that an Uselton associate named Scott Sieck controlled, sold over 4.5 million shares for a net profit of \$676,184.68.

Golden Apple Oil and Gas, Inc. ("GAPJ"): On February 9, 2006, Thimble deposited 1.2 million shares of GAPJ stock into its Leeb account, based on a direct issuance from the issuer. Thus, the shares were restricted, and not freely tradeable to the public. Moreover, Golden Apple papered the transaction with a convertible promissory note that had purportedly been issued in December 2004—nine months before Thimble had been incorporated.

Moreover, only four days after delivering in the initial block of shares, Thimble received in another 390,000 shares from a third party via DTC. The transferor was controlled by the person who had been Golden Apple's secretary until one month prior to transfer. (When the transferor obtained its shares from Golden Apple, that transfer was

also accompanied by a sham promissory note.)

In addition, Bloomfield and Martin eventually sold a total of 1.17 million of Thimble's GAPJ shares to the public even though the issuer had only made outdated financial information available to the public; the issuer had not publicly disclosed the share issuance to Thimble; the stock was the subject of a spam campaign; and the Commission had temporarily suspended trading in the security.

Lifeline Biotechnologies, Inc.: In the fall of 2005, Labi customer Gerald Alexander became involved with a stock called Lifeline Biotechnologies, Inc., and messaged Labi concerning his anticipated receipt of stock certificates and commencement of an IR campaign: "cert should hit any minute in FL to sign IR for LBTN will kick off soon." Then, beginning in January 2006 and for every month of that year, Alexander delivered large blocks of Lifeline stock into the Regis Filia and CJB Consulting accounts at Leeb. Ultimately, Alexander delivered in more than 1 billion shares of Lifeline to his Leeb accounts, and sold over 850 million of those shares through Leeb.

As of January 2006, Lifeline's total outstanding share balance equaled 181.8 million shares. By the end of 2006, there were 6.7 billion shares outstanding. Through repeated offerings -- with never more than a month between offerings -- Alexander's companies obtained 2 billion shares of Lifeline representing 31.6 % of all newly-issued shares from during 2006, and 30.75% of the total outstanding share balance as of December 31, 2006.

One year earlier, on December 15, 2005, Alexander had sent Labi an IM about

Lifeline, saying “lots of news and IR frist[sic] quarter.”<sup>5</sup>

### **Leeb’s AML program**

Leeb’s written AML program contained examples of red flags that could be indicative of suspicious activities, including a history of criminal, civil or regulatory violations by the customer or an associate; an LLC with multiple addresses; multiple transfers of funds to or from bank secrecy jurisdictions, tax havens, or non-cooperative jurisdictions as identified by the Financial Action Task Force (“FATF”) or FinCEN; or penny stock activity. In addition to the red flags listed above, the SAR form used by the securities industry to report suspicious activity includes the following securities specific offenses: insider trading; market manipulation; prearranged or other non-competitive trading; securities fraud, and wash or other fictitious trading. Leeb’s AML program required a preliminary risk assessment when an account was opened, and subsequent account activity reviews to detect any reportable activities or transactions.

All Leeb employees were expected to be familiar with Leeb’s AML policies and procedures and were charged with responsibility for compliance. The firm’s AML program also charged designated Principals, which included Bloomfield, with daily supervision of RRs’ business activities, including detecting suspicious transactions or activity in their daily, weekly and/or monthly reviews.

### **Gorgia’s Supervisory Responsibilities and Conduct**

Gorgia was Leeb’s Chief Compliance Officer and supervisor of the firm’s AML program from February 2005 until July 2006. During that period, the firm’s Written Supervisory Procedures (“WSP”) gave him significant responsibilities, such as being in

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<sup>5</sup> The evidence at trial will also pertain to additional suspicious trading activity, including additional IMs between Labi and his customers.

charge of the firm's Supervisory System and its Supervisory Control System, with responsibility for insuring that the firm had adequate procedures.

The WSP also gave Gorgia responsibility for monthly review of customer account activity. Leeb's AML compliance program stated that "[m]onitoring transactions is essential to determining if unusual or suspicious activities are taking place," and incorporated by reference the transaction, trade, and supervisory review procedures set forth in the WSP. He additionally was responsible for electronic communication review (such as Labi's IMs), and as AML Supervisor shared responsibility for reviewing wire transfer activity and exception reports.

Gorgia also had a supervisory role with respect to the OSJ. When Leeb undertook the process of opening its OSJ, Gorgia represented to the NASD that "Mr. Bloomfield will be supervised by both Mr. Miller and myself in New York." He further added that Leeb and the Compliance department "have informed Mr. Bloomfield that it will not tolerate the slightest deviation from Compliance. If the audits, which I will conduct at least quarterly reveal any major violations or numerous minor violations, Mr. Bloomfield will be dismissed." Furthermore, he signed a document attesting that whereas AML supervision for the intended OSJ would be handled at the OSJ, by Bloomfield, the "review of AML procedures and the review of the OSJ AML activities remain the responsibility of and the obligation of Robert Gorgia."

As Gorgia acknowledged in his testimony, he did indeed conduct one audit of the OSJ, but Leeb's WSP was not timely modified to reflect the existence of the OSJ, the fact that Bloomfield was a producing manager at the OSJ, or Gorgia's supervisory role. When the revised procedures finally were drafted in June 2006, the WSP finally

recognized the Compliance Department's role in supervising the OSJ, including weekly account supervision.

Although Gorgia recognized the compliance concerns raised by the firm's penny stock business, calling it a "compliance nightmare," he did not regularly review trading runs or scrutinize the ongoing practice of Bloomfield, Martin and Labi's customers to deliver in privately obtained penny stocks and sell them to the public through the firm. Had he performed such tasks, he would have been in an even better position to uncover additional suspicious factors such as the ones detailed above, and to detect the registered representatives' facilitation of unregistered distributions.

Further, even though Gorgia knew that Leeb's controls with regard to Leeb's duty of reasonable inquiry were deficient, he failed to correct the situation by putting in place adequate procedures. Beginning in April 2005, Pershing, Leeb's clearing firm, requested that Gorgia provide them with a copy of Leeb's low priced security transaction procedures, together with an outline of Leeb's due diligence process with respect to individuals and entities involved in such transactions. There is no evidence that any such procedures existed at the time or were drafted and supplied to Pershing. Rather, Gorgia appears to have ignored this compliance gap in an area that he conceded presented compliance risk. Even when Leeb completed the questionnaires, its inquiry was superficial at best as Leeb failed to collect documentation confirming how its customers obtained shares and ignored suspicious information like recent acquisitions of unrestricted shares directly from the issuer.

Ultimately, unable to obtain a satisfactory response to its compliance concerns, Pershing terminated its relationship with Leeb by letter dated December 13, 2005. Leeb

simply found another clearing firm, and Gorgia did nothing to enhance its procedures. In short, Gorgia did not develop procedures for insuring that the firm's registered representatives conducted a reasonable inquiry into their customers' penny stock sales. Had he done so, it is likely that he would have detected and prevented the RRs violations of Section 5.

Gorgia's performance of AML compliance was similarly lacking. Despite numerous communications from Pershing, and despite numerous inquiries from regulators, he could not recall placing any accounts under heightened scrutiny or reviewing any clearing firm AML reports. In fact, Gorgia testified that he "[didn't] know what an AML report from Pershing would be," and when shown such a report available to Leeb said that he would have been "extremely concerned" had he seen it while a compliance officer.

## ARGUMENT

### **I. BLOOMFIELD, MARTIN AND LABI VIOLATED SECTION 5 OF THE SECURITIES ACT**

Sections 5(a) and 5(c) of the Securities Act prohibit the offer and sale of securities in interstate commerce unless a registration statement is filed with the Commission or is in effect, or the securities transactions are exempt or fall within a safe-harbor from registration. To establish a *prima facie* case for a violation of the registration provisions, the Commission must prove that (1) the defendant offered to sell or sold a security; (2) the defendant used the mails or interstate means to sell or offer the security; and (3) no registration statement was filed or was in effect as to the security. See SEC v. Cavanagh, 1 F. Supp2d. 337, 361 (S.D.N.Y. 1998), aff'd, 155 F.3d 129 (2d Cir. 1998). Once the Commission establishes a *prima facie* case, the burden of proof shifts to the defendant to

show that an exemption or safe-harbor from registration was available. See SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953). Scierter is not required to establish a Section 5 violation, see SEC v. Softpoint, Inc., 958 F. Supp. 846, 859-60 (S.D.N.Y. 1997), aff'd mem., 159 F.3d 1348 (2d Cir. 1998), and liability extends to all necessary participants in the unregistered sale of stock. Cavanagh, 1 F. Supp.2d at 372.

As a general matter, Rule 144 provides guidance as to how persons can sell restricted or affiliate-owned shares without being deemed to have engaged in a distribution, and stock sellers such as Leeb's customers need to comply with that rule in order to qualify for the registration exemption provided by Section 4(1) of the Securities Act. Where such customers do not have valid Section 4(1) exemptions, their brokers can avoid liability for participation in unregistered offerings, but only if they engage in "brokers' transactions" under Section 4(4) in accordance with the requirements of Rule 144(g). Rule 144(g) in turn sets out a requirement that brokers conduct a "reasonable inquiry" before selling the securities.

When a customer brings in stock that was not obtained in a registered offering, and attempts to sell that stock to the public, the broker is obligated to conduct an "adequate inquiry under the circumstances." Wonsover v. SEC, 205 F.3d 408, 409 (D.C. Cir. 2000), quoted in Geiger v. SEC, 363 F.3d 481, 487 (D.C. Cir. 2004). As an exception to the registration requirement upon resale to the public, Rule 144 permits a "broker's transaction" if the broker "[a]fter reasonable inquiry is not aware of circumstances indicating that the person for whose account the securities are sold is an underwriter with respect to the securities or that the transaction is a part of a distribution

of securities of the issuer.” A Commission release clarifies when a broker’s inquiry can be considered reasonable:

The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for.

Distribution by Broker-Dealers of Unregistered Securities, Securities Act Rel. No. 33-4445 (Feb. 2, 1962).

Moreover, a broker’s duty is non-delegable -- a broker may not rely on a transfer agent to fulfill its reasonable inquiry obligation. Wonsover, 205 F.3d at 416 (rejecting registered representative’s reliance on clearing firm, the transfer agent and counsel); see also Stead v. SEC, 444 F.2d 713, 716 (10th Cir.1971) (“The act of . . . calling the transfer agent is obviously not a sufficient inquiry.”); A.G. Becker Paribas Inc., 48 S.E.C. 118, 121 (1985) (“If a broker relies on others to make the inquiry called for in any particular circumstances, it does so at its peril.”); Geiger, 363 F.3d at 485 (registered representative willfully violated Section 5 by “abandon[ing] even the pretense of due diligence”); Graham v. SEC, 222 F.3d 994, 1005-06 (D.C. Cir. 2000) (rejecting reliance on supervisor defense to negate a registered representative’s “independent duty to use diligence”). Nor may brokers simply rely on customer’s self-serving statements without exploring the facts, particularly where, as here, they were aware that their customers routinely obtained stock directly from issuers. See Kane v. SEC, 842 F.2d 194, 200 (8th Cir. 1988). Absent a reasonable inquiry, a broker who participates in the unregistered sale

of securities violates Section 5 of the Securities Act.

In light of the numerous red flags surrounding the activities of Leeb's customers, there was a constant need for a "searching inquiry" into the stock that was being delivered into the firm. Bloomfield, Martin and Labi repeatedly allowed customers, including persons known to them as consultants and promoters that would have direct ties to issuers, to deliver in large blocks of penny stocks without undertaking any critical inquiry into the source of the shares to ensure that they were not restricted or control shares.

**II. GORGIA FAILED REASONABLY TO SUPERVISE BLOOMFIELD, LABI AND MARTIN WITH A VIEW TO PREVENTING AND DETECTING THEIR SECTION 5 VIOLATIONS**

Under Section 15(b)(4), supervisors must respond reasonably when confronted with red flags suggesting that an registered representative may be engaging in improper activities. See George J. Kolar, Exchange Act Rel. No. 46127, 2002 SEC LEXIS 1647 (Commission Opinion, June 26, 2002). Moreover, a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them also constitutes a failure to supervise. See Stephen J. Horning, Exchange Act Rel. No. 56886, 2007 SEC LEXIS 2796 at \*27 and n.17 (Commission Opinion, Dec. 3, 2007) (supervisor failed to uncover errors because of cursory review of reports), aff'd, 570 F.3d 337 (D.C. Cir. 2009).

In addition to Gorgia's supervisory responsibilities, compliance officers as a general matter, whether or not they are "in line" supervisors of registered representatives, are responsible for supervisory failures if, under the particular circumstances of the case, they have "a requisite degree of responsibility, ability or authority to affect the conduct of

the employee whose behavior is at issue.” Marion Bass Securities Corp., Exchange Act Rel. No. 43754, 2000 SEC LEXIS 2806 at \*5-6 (Dec. 20, 2000). As with any non-line supervisors, liability turns on whether the person had responsibility for a particular area of conduct and was in a position to control that conduct. Marshall Dornfeld, Exchange Act Rel. No. 55209, 2007 SEC LEXIS 214 at \*12 (Jan. 31, 2007); Robert J. Check, Exchange Act Rel. No. 26367, 49 S.E.C. 1004 at 1008 (Dec. 16, 1988).

As explained above, registration violations by Bloomfield, Martin and Labi occurred because Gorgia ignored red flags that they were not conducting adequate reviews, failed to conduct necessary reviews when confronted with facts calling out for them, and failed to put in place procedures that would have detected and prevented the unlawful conduct. Although Gorgia had overlapping supervisory responsibilities with former president Miller, that does not absolve him of his own obligation to supervise. See James J. Pasztor, Exchange Act Rel. No. 42008, 54 S.E.C. 398 at n.28 (Commission Opinion, Oct. 14, 1999) (individual not relieved of supervisory duties because supervisory authority was shared with another).

### **III. BLOOMFIELD, GORGIA, LABI AND MARTIN WILLFULLY AIDED AND ABETTED AND CAUSED VIOLATIONS OF SECTION 17(a) OF THE EXCHANGE ACT AND RULE 17(a) THEREUNDER**

The BSA,<sup>6</sup> as amended by the USA PATRIOT Act<sup>7</sup> and implemented under rules promulgated by the U.S. Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”), requires that broker-dealers file SARs with FinCEN to report a transaction

<sup>6</sup> Currency and Financial Transactions Reporting Act of 1970, 12 U.S.C. §§ 1951-1959, and 31 U.S.C. §§ 5311-5330.

<sup>7</sup> Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 296 (2001).

(or a pattern of transactions of which the transaction is a part) involving or aggregating to at least \$5,000 that the broker-dealer knows, suspects or has reason to suspect: (1) involves funds derived from illegal activity or were conducted to disguise funds derived from illegal activities; (2) were designed to evade any requirements of the BSA; (3) had no business or apparent lawful purpose; or (4) involved use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 103.19 (“SAR Rule”). Exchange Act Rule 17a-8 requires broker-dealers to comply with the recordkeeping, retention, and reporting obligations of the regulations under the BSA. The failure to file a SAR, as required by the SAR Rule, is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder, and is enforceable by the Commission. See, e.g., Park Financial Group, Inc., Exchange Act Rel. No. 56902, 2007 SEC LEXIS 2824 (Settled Order, Dec. 5, 2007); Ferris Baker Watts, Inc., Exchange Act Rel. No. 59372, 2009 SEC LEXIS 305 (Settled Order, Feb. 10, 2009).

Aiding and abetting violations of the securities laws involve three elements: (1) a primary or independent securities law violation committed by another party; (2) substantial assistance by the aider and abettor in the conduct constituting the primary violation; and (3) provision of that assistance with the requisite scienter. In the Matter of vFinance Investments, Inc., 2010 SEC LEXIS 2216 at \*41 (July 2, 2010). As the Commission has recently affirmed, the scienter element is satisfied if the aider and abetter “knew of, or recklessly disregarded, the wrongdoing and [his] role in further it.” Id.

“Causing” liability also requires the establishment of three elements: (1) a primary violation; (2) an act or omission by the respondent that was the cause of the

violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. Robert M. Fuller, Exchange Act Rel. No. 48406, 2003 SEC LEXIS 2041 at \*13-14 (Commission Opinion, Aug. 25, 2003), petition denied, 95 Fed. Appx. 361 (D.C. Cir. 2004). Negligence is sufficient to establish causing liability at least in cases where the primary violation does not require scienter. Joseph John Vancook, Exchange Act Rel. No. 61039A, 2009 SEC LEXIS 4040 at \*57 n.65 (Commission Opinion, Nov. 20, 2009). Aiders and abettors of a violation also cause the violation. Warwick Capital Mgmt., Inc., Inv. Adv. Act Rel. No. 2694, 2008 SEC LEXIS 96 at n.21 (Commission Opinion, Jan. 16, 2008).

During the period under investigation, Leeb failed to file SARs on the activities and transactions of its customers even though these activities and transactions met the SAR Rule's dollar threshold reporting requirements and, at the very least, did not appear to have a business or apparent lawful purpose. In particular, Bloomfield and Martin's customers, the Useltons and Thimble, each engaged in a series of penny stock transactions that should have been suspected as potential registration violations, that suspiciously coincided with price or volume spikes, or penny stock promotional campaigns, or that were indicative of market manipulation. Furthermore, the circumstances surrounding their business and/or the organization of their accounts, such as the Thimble account's jurisdiction of incorporation and international wire transfer activity, raised additional red flags.

Likewise, Labi's customers, including Gerald Alexander, engaged in a similar pattern of penny stock activity, delivering in and selling out large volumes of penny stock shares that should have been suspected as registration violations; engaging in

conspicuous stock promotional activities; trading based on advance information about promotional activity; and organizing two corporate accounts in a manner that raised red flags requiring the filing of a SAR. Leeb did not file a single SAR with FinCEN, as required by the SAR Rule, concerning any of the transactions and activities in these accounts. Leeb's failure to file a SAR is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.<sup>8</sup>

Gorgia, Bloomfield, Martin and Labi aided and abetted and caused Leeb's violations of Section 17(a) and Rule 17a-8. Gorgia, Bloomfield, Martin and Labi all were aware of their ongoing obligation to monitor and report suspicious activity and knew, or were reckless in not knowing, of the suspicious transactions and activities that were occurring through the firm. Bloomfield, Martin, and Labi, as the responsible RR's who managed the day to day activity in their respective customer accounts, were well aware of all of the details of their customers' accounts that triggered Leeb's obligation to file a SAR, including their customers' use of multiple LLCs, the location, organization and substance of their customers' business, the wire transfer activity, and suspicious trading. Yet they took no steps to initiate the filing of a SAR by Leeb.

Gorgia, as Compliance Officer and AML supervisor, was confronted repeatedly with problematic customer activity, yet failed to act on it. By failing to do so, he aided and abetted and caused Leeb's violations.

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<sup>8</sup> On January 4, 2010, the Commission obtained a default judgment against Gerald Alexander in an action including Section 5 claims based in part on activity conducted through Leeb. See Lit. Release No. 21363 (SEC v. Alexander, No. 1:09-cv-0805-HTW (N.D. Ga.)). On March 18, 2009, the Commission obtained a consent judgment against Darrel and Jack Usleton for spam-related activity including, in part, stocks traded through Leeb. See Lit. Release No. 20961 (SEC v. Usleton et al., No. 07-2211 (S.D. Tex.)).

#### **IV. THE COURT SHOULD IMPOSE MEANINGFUL SANCTIONS AND OTHER REMEDIES AGAINST RESPONDENTS**

##### **A. Bloomfield, Martin, Labi and Gorgia Should Be Barred From Association With Any Broker-Dealer**

Section 15(b) of the Exchange Act, 15 U.S.C. § 78o(b), authorizes the Commission, if it finds that it is in the public interest, to bar any person from being associated with any broker or dealer. Such actions can be taken against any person who, among other things, has willfully violated or willfully aided and abetted any other person's violation of any provision of the Securities Act, the Exchange Act, or any of the rules and regulations promulgated under those statutes.

The public interest analysis requires consideration of the following factors: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infractions; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of their conduct; and (6) the likelihood that their occupation will present opportunities for future violations. See, e.g., Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979); In the Matter of Weeks, Admin. Proc. File No. 3-9952, 2002 WL 169185 (Initial Decision Feb. 4, 2002). The severity of the sanction depends on the facts of each case and the value of the sanction in preventing a recurrence of the violative conduct. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963).

As discussed above, Bloomfield, Martin, Labi and Gorgia each willfully violated or aided and abetted and caused violations of provisions of the Securities Act and/or the Exchange Act, and rules promulgated under those statutes. Thus, permanent bars against

Bloomfield, Martin, Labi and Gorgia are in the public interest and warranted in this case in light of their egregious conduct as described above.

**B. Penny Stock Bars Are Appropriate**

The securities at issue come within the definition of “penny stock” because the issuers fail to qualify for any of the exceptions defined by Section 3(a)(51) of the Exchange Act and Rule 3a51-1 thereunder. The securities were sold for less than \$5 per share and were never traded on an exchange or quoted on the NASDAQ. In addition, the issuers do not meet the exceptions based upon financial thresholds contained in Rule 3a51-1(g). Because of their roles in the Leeb customers’ penny stock sales to the public, permanent penny stock bars against Bloomfield, Martin, Labi and Gorgia are also appropriate.

**C. Cease and Desist Orders Are Warranted Against Bloomfield, Martin, Labi and Gorgia**

Section 21C of the Exchange Act, 15 U.S.C. § 78u-3, authorizes the Commission to order a person who has been found to have violated any provision of the Exchange Act, or the rules and regulations thereunder, or caused any such violation by an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violations, or future violations. Similarly, Section 8A of the Securities Act, 15 U.S.C. § 77h-1, and Section 9(f) of the Investment Company Act, 15 U.S.C. § 80-9(f), authorize the Commission to enter cease-and-desist orders prohibiting violations of the Securities Act and the Investment Company Act, respectively.

As described above, Bloomfield, Martin and Labi and Gorgia each willfully violated Section 5(a) and 5c) of the Securities Act; Gorgia failed reasonably to supervise

Bloomfield, Labi and Martin within the meaning of Sections 15(b)(4) and 15(b)(6) of the Exchange Act; and Bloomfield, Martin, Labi and Gorgia willfully aided and abetted and caused violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Their actions demonstrate a conscious disregard of the federal securities laws. Accordingly, cease-and-desist orders against Bloomfield, Martin, Labi and Gorgia are appropriate to prevent violations and future violations of the statutes and rules set forth above.

**D. Bloomfield, Labi and Martin Should Be Required to Disgorge Their Ill-Gotten Gains**

Bloomfield, Labi and Martin should each be ordered to pay disgorgement plus prejudgment interest. “The primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws.” SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1474 (2d Cir. 1996) (citations omitted). Moreover, “effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable.” Id. (quoting SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d Cir. 1972)). “To the extent that compensation flows from ill-gotten gains, the offending parties should be required to disgorge such to prevent unjust enrichment.” SEC v. Rogers, 221 F.3d 1349 (Table), 2000 WL 642467, at \*2 (9th Cir. May 18, 2000) (citation omitted).

When calculating disgorgement, however, “separating legal from illegal profits exactly may at times be a near-impossible task.” SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989). Disgorgement, therefore, “need only be a reasonable approximation of profits causally connected to the violation.” Id. See also First Jersey Sec., Inc., 101 F.3d at 1475; SEC v. Drexel Burnham Lambert, 837 F. Supp. 587, 612 (S.D.N.Y. 1993), aff’d 16 F.3d 520 (2d Cir. 1994), cert denied 513 U.S. 1077 (1995).

“[A]ny risk of uncertainty [in calculating disgorgement] should fall on the wrongdoer whose illegal conduct created that uncertainty.” First Jersey Sec., 101 F.3d at 1475 (quotation omitted). Once the Division establishes a reasonable approximation of unjust enrichment, the burden then shifts to respondent. See SEC v. Lorin, 76 F.3d 458, 462 (2d Cir. 1996).

Bloomfield, Labi and Martin should each be ordered to disgorge compensation earned during the relevant period attributable to penny stock transactions. Given the egregious nature of the conduct, it would be unjust for the Court to allow Bloomfield, Labi and Martin to retain their penny stock commissions earned during the period. See In the Matter of Trautman Wasserman & Company, Inc., Admin. Proc. File No. 3-12559, 2008 WL 149120, at \*24-25 (Initial Decision Jan. 14, 2008) (Murray, ALJ) (ordering disgorgement of respondent Trautman’s compensation during the relevant period); In the Matter of Kenneth R. Ward, Admin. Proc. File No. 3-9237, 2003 WL 1447865, \*14 (March 19, 2003) (disgorgement of commissions earned during relevant period).

**E. Respondents Should Pay Prejudgment Interest on Disgorgement**

Bloomfield, Labi and Martin should be ordered to pay prejudgment interest on any disgorgement ordered through the date of entry of an order directing disgorgement. Prejudgment interest deprives a defendant of an interest-free loan in the amount of his ill-gotten gains, thereby preventing unjust enrichment. SEC v. Grossman, No. 87 Civ. 1031, 1997 WL 231167, at \*11 (S.D.N.Y. May 6, 1997), aff’d in part and vacated in part on other grounds, 173 F.3d 846 (2d Cir. 1999). In calculating prejudgment interest on disgorgement ordered for securities law violations, the Commission uses the Internal Revenue Service’s “underpayment rate,” which is a floating interest rate that the IRS uses

to determine interest due on underpaid taxes, in administrative proceedings. *See* 17 C.F.R. § 201.600(b). The IRS rates are not punitive, but rather are set at a level to prevent unjust enrichment. *See* 26 U.S.C. § 6621(a)(2); SEC Rules & Regulations, 60 Fed. Reg. 32738, 32788 (June 23, 1995).

**F. Bloomfield, Labi, Martin and Gorgia Should  
Be Required to Pay Substantial Penalties**

Under Section 21B of the Exchange Act, 15 U.S.C. § 78u-2, the Commission may impose civil monetary penalties in proceedings instituted under Section 15(b) of the Exchange Act, against any person who is found to have willfully violated, or aided and abetted, any provision of the Exchange Act if such penalties are in the public interest. Six factors are relevant to determining whether civil monetary penalties are in the public interest: (1) deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. *See* Section 21B(c) of the Exchange Act. “Not all factors may be relevant in a given case, and the factors need not all carry equal weight.” In the Matter of Robert G. Weeks, Admin. Proc. File No. 3-9952.

Section 21B(b) of the Exchange Act specifies a three-tier system identifying the maximum amount of civil penalties, depending on the severity of the respondent’s conduct. Second tier penalties are awarded in cases involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. Third-tier penalties are awarded in cases where such state of mind is present, and, in addition, where the conduct in question directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons, or resulted in substantial

pecuniary gain to the person who committed the act or omission. In this proceeding, the Division respectfully submits that third-tier penalties are appropriate against Bloomfield, Martin, Labi and Gorgia.

**V. RESPONDENTS' PRE-HEARING MOTIONS SHOULD BE DENIED**

The Court should deny the motion in limine to exclude the Division's expert report of the Robert Lowry, and Gorgia's motion for summary disposition.

First, Bloomfield and Martin argue that Mr. Lowry's report should be excluded in its entirety because it "merely offers legal analysis and conclusions, impermissibly usurping the essential function of the hearing officer." Mot. at 6. This assertion is without merit. Mr. Lowry's report contains no legal conclusions. Instead, the report is based on Mr. Lowry's review of trading records and his knowledge of industry practices. A similar objection to an expert report by Mr. Lowry was soundly rejected in 2002 by the US District Court for the Southern District of New York. See SEC v. US Environmental, Inc. et al., 2002 U.S. Dist. LEXIS 19701 (S.D.N.Y. Oct. 16, 2002) (denying motion in limine to exclude expert report by Mr. Lowry).

Second, Gorgia's motion for summary disposition should be denied. Under Rule of Practice 250, "a motion for summary disposition shall be made only with leave of the hearing officer." Gorgia failed to obtain leave to file, therefore his motion should be denied.

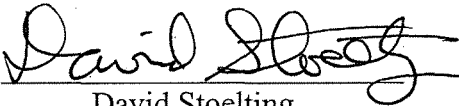
**CONCLUSION**

Based on the foregoing, the Division respectfully requests that this Court make findings of fact with regard to the misconduct discussed above and that the requested sanctions be imposed on the Respondents.

Dated: New York, New York  
September 3, 2010

Respectfully submitted,

DIVISION OF ENFORCEMENT

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