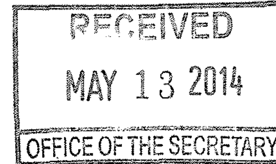
UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15514

In the Matter of

DONALD J. ANTHONY, JR.,
FRANK H. CHIAPPONE,
RICHARD D. FELDMANN,
WILLIAM P. GAMELLO,
ANDREW G. GUZZETTI,
WILLIAM F. LEX,
THOMAS E. LIVINGSTON,
BRIAN T. MAYER,
PHILIP S. RABINOVICH, and
RYAN C. ROGERS,

Respondents.



PHIL RABINOVICH, BRIAN MAYER, AND RYAN ROGERS' JOINT POST-HEARING BRIEF

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Respondents Philip S. Rabinovich ("Rabinovich"), Brian T. Mayer ("Mayer"), and Ryan C. Rogers ("Rogers"), respectfully submit this joint post-hearing brief.

Preliminary Statement

The evidence at the hearings conclusively established that Rabinovich, Mayer and Rogers did *not* violate Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5 thereunder (the "Fraud Claim"), or Securities Act Section 5(a) and (c) (the "Section 5 Claim").

They did not make any material misrepresentations or omissions in presenting any McGinn Smith Securities[1] to any of their clients. They fulfilled their obligations as registered representatives by performing a product suitability and client suitability assessment before they presented each McGinn Smith Security to their clients. They also continued to research and monitor their clients' investments. Indeed, they went beyond what was required of them as registered representatives and went to extraordinary lengths to help their clients after they left McGinn Smith at the end of October 2009.

The evidence irrefutably demonstrated that there were no "red flags" which should have caused Rabinovich, Mayer and Rogers to conduct a heightened inquiry, and, in any event, their inquiry was sufficient. Like their clients, Rabinovich, Mayer and Rogers were victims of Tim McGinn and Dave Smith's secret theft and diversion of funds, as well as the global financial crisis that impacted the investments.

Rabinovich, Mayer and Rogers took reasonable steps to avoid participating in any distribution in alleged violation of Section 5(a) and (c). They presented McGinn Smith Securities to their accredited investor clients, and those few who were not accredited either had been accredited or had the requisite knowledge and experience in financial and business matters

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[1] Capitalized terms not otherwise defined herein shall have the meaning given to them in Rabinovich, Mayer and Rogers' joint proposed findings of fact.

to evaluate the merits and risks of the investment. Rabinovich, Mayer and Rogers followed McGinn Smith's written procedures for offering private placements; they had their clients complete subscription agreements and questionnaires to confirm their accredited status or knowledge and experience; they spoke with and were informed by McGinn Smith's legal, compliance and investment banking departments that the McGinn Smith Securities were exempt from registration; and they knew outside counsel had advised McGinn Smith that the offerings were exempt from registration. The Section 5 Claim also fails because the six-month safe harbor of Rule 502(a) precludes any integration analysis of the separate Trust Offerings. And, the five-factor test contained in the notes of that rule, applicable only to separate offerings made within six months, also nullifies the Division's claim.

Moreover, no claim survives here because 28 U.S.C. § 2462 bars this proceeding *in its entirety*. No tribunal had subject matter jurisdiction to hear this case, as all of the alleged claims in the OIP "*first accrued*" more than five years before the OIP was filed (that is, before September 23, 2008). At the very least, no penalty – including the Division's proposed punitive lifetime bar from the securities industry and forfeiture dressed up as "disgorgement" – may be imposed based on conduct that occurred prior to September 23, 2008, which comprises the majority of conduct alleged in this case.

The Division's charges against Rabinovich, Mayer and Rogers were not proven and should be dismissed in their entirety.

STATEMENT OF FACTS

Rabinovich, Mayer and Rogers incorporate by reference their joint proposed findings of fact ("FoF") as the facts supporting dismissal of the Division's claims.

ARGUMENT

I.

RABINOVICH, MAYER, AND ROGERS DID NOT VIOLATE SECURITIES ACT SECTION 17(A) OR EXCHANGE ACT SECTION 10(B) AND RULE 10B-5 THEREUNDER

The Division failed to establish that Rabinovich, Mayer and Rogers violated Securities Act Section 17(a) or Exchange Act Section 10(b) and Rule 10b-5 thereunder. Rabinovich, Mayer, and Rogers more than complied with their duties as registered representatives, and certainly did not intentionally, recklessly, or even negligently violate the antifraud provisions of the federal securities laws. Nor did the Division establish that there were any "red flags" known to Rabinovich, Mayer and Rogers that would have altered their duties in the manner that the Division asserts. And, despite the Division's post-OIP attempt to round up its witnesses and evidence, not a single investor identified any material misrepresentations or omissions made by Rabinovich, Mayer and Rogers. For these reasons, the Fraud Claim should be dismissed.

A. Section 10(b), Rule 10b-5, and Section 17(a)(1) Liability May Be Imposed Only for Intentional or Reckless Conduct Not Present Here

Section 10(b) of the Exchange Act makes it unlawful "for any person . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). The text of the statute "clearly connotes intentional misconduct," and "[t]here is no indication that Congress intended anyone to be made liable for such [manipulative or deceptive] practices unless he acted other than in good faith." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201, 206 (1976) (no Section 10(b) liability stated against auditor of brokerage firm based on its alleged failure to discover a fraudulent scheme in

the absence of an intent to defraud). Indeed, the Supreme Court has expressly declined "to extend the scope of the statute to negligent conduct." *Id.* at 214.

Section 17(a)(1) of the Securities Act likewise makes it unlawful "for any person in the offer or sale of any securities . . . to employ any device, scheme, or artifice to defraud." 15 U.S.C. § 77q(a)(1). Similar to Section 10(b), "[t]he language of § 17(a)(1) . . . plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct." *Aaron v. SEC*, 446 U.S. 680, 696 (1980).

Accordingly, insofar as the Division bases its Fraud Claim on Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, or Section 17(a)(1) of the Securities Act, it must establish that Rabinovich, Mayer, and Rogers acted with *scienter* – a state of mind embracing the intent to deceive, manipulate or defraud. *See Aaron*, 446 U.S. at 686 n.5, 697; *Hochfelder*, 425 U.S. at 193. The Division has not met its burden here.

To plead (and by extension, prove) the requisite fraudulent intent, a plaintiff must either "show that defendants had both motive and opportunity to commit fraud," or adduce "facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness."[2] *Kalnit v. Eichler*, 264 F.3d 131, 138-39 (2d Cir. 2001) (internal quotations omitted). The OIP did not allege, and the Division did not contend, that Rabinovich, Mayer or Rogers had a motive to defraud their clients. *See, e.g., In re Merrill Lynch Auction Rate Sec. Litig.*, 851 F. Supp. 2d 512, 528 (S.D.N.Y. 2012) (alleged motive "to increase or maintain profit" deemed insufficient as such motive "could be imputed to any for-profit endeavor"); *Defer LP v. Raymond James Fin., Inc.*,

[2] Although the Division, in this administrative proceeding, is not subject to the heightened pleading standards for fraud that would have been required in a federal district court, the Division must still prove its case with reliable, probative and sufficient evidence on the essential elements of the Fraud Claim. *See Steadman v. SEC*, 450 U.S. 91, 98 (1981); 5 U.S.C. § 556. The Division has failed to do so here.

654 F. Supp. 2d 204, 217-18 (S.D.N.Y. 2009) (brokers' supposed motive to "earn substantial sales commissions and fees for underwriting" auction rate securities rejected as support for Section 10(b) liability because it does not show an intent to defraud). Thus, where, as here, evidence of motive is non-existent, the Division's circumstantial evidence of recklessness "must be correspondingly greater." *Kalnit*, 264 F.3d at 142 (internal quotations omitted).

In this context, courts have long defined "reckless" conduct as an approximation of actual intent to defraud. *See Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 47 (2d Cir. 1978) (reckless conduct is "at the least, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care *to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.*") (emphasis added and internal quotations omitted); *see also Chill v. Gen. Elec. Co.*, 101 F.3d 263, 269 (2d Cir. 1996) (recklessness "must, in fact, approximate an actual intent to aid in the fraud being perpetrated") (citation omitted); *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) ("[R]ecklessness should be viewed as the functional equivalent of intent . . . .").

The Second Circuit recently reiterated that limitation in dismissing a Section 10(b) claim made against an investment advisor who "recklessly" recommended an investment in a Ponzi scheme, because there were no facts to support a finding of *scienter*. *See South Cherry St., LLC v. Hennessee Group LLC*, 573 F.3d 98, 109 (2d Cir. 2009) (defining recklessness as "a state of mind *approximating actual intent,* and *not merely a heightened form of negligence*") (emphasis in original). In *South Cherry*, a registered investment advisory firm, retained by an investor with little experience in making hedge fund investments, promised to employ a proprietary "due diligence process" that included "five levels of scrutiny" – including

examinations of audited financial statements, interviews of hedge fund personnel and collecting information about fund managers. 573 F.3d at 100-101. In recommending an investment in the Bayou Accredited Fund, which later turned out to be a Ponzi scheme, the investment advisor failed to do the due diligence that it promised. *See id.* at 103. Nonetheless, the Court found no Section 10(b) and Rule 10b-5 liability, because the investment advisor did not fail to conduct the promised due diligence with any knowledge of the fraud or intent to deceive. *Id.*[3]

Section 10(b) and Section 17(a)(1) claims against investment advisors or broker-dealers are not stated upon even grossly negligent failures of diligence where the "recklessness" at issue did not approximate an actual intent to defraud their customers. *See, e.g.*, *Gabriel Capital, L.P. v. NatWest Fin., Inc.*, 137 F. Supp. 2d 251, 263 (S.D.N.Y. 2000) ("[a]n investment advisor . . . is not required to assume the role of accountant or private investigator and conduct a thorough investigation of the accuracy of the facts contained in the documents that it analyzes for the purpose of recommending an investment. The investment advisor is not the author of those documents and does not purport to certify the accuracy of those documents").

B. Rabinovich, Mayer And Rogers Did Not Intentionally or Recklessly Neglect Their Obligations As Registered Representatives

1. The Obligations of a Registered Representative

It is well-settled that "there is no general fiduciary duty inherent in an ordinary broker/customer relationship." *Independent Order of Foresters v. Donald, Lufkin & Jenrette, Inc.*, 157 F.3d 933, 940-41 (2d Cir. 1998). Rather, a registered representative engaging in

[3] On these same facts, the Commission entered a settled order against the investment advisor and its principal for violation of Section 206(2) of the Investment Advisers Act of 1940, which does not require a finding of *scienter*. *See Matter of Hennessee Group LLC*, File No. 3-13454, 2011 SEC LEXIS 1086, at 7 (Apr. 22, 2009). Although the investment advisor agreed to certain penalties and undertakings, neither the investment advisor nor its principal were barred or suspended from the securities industry. *See id.* at 7-8.

transactions in a non-discretionary account – as Rabinovich, Mayer, and Rogers did here (FoF ¶¶ 366, 419, 483) – "owes duties of diligence and competence in executing the client's trade orders, and is obliged to give honest and complete information when recommending a purchase or sale." *De Kwiatkowski v. Bear, Stearns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002).

When an investment recommendation is made by a broker-dealer (member firm) or one of its associated persons, NASD (n/k/a FINRA) rules require that it be suitable. Specifically, NASD Rule 2310(a), the operative rule in effect during the relevant time period, provides that "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." NASD Rule 2310(a). This is consistent with *Hanly v. SEC*, 415 F.2d 589 (2d Cir. 1969), the centerpiece of the Division's theory of liability, which held that a broker "cannot recommend a security unless there is an adequate and reasonable basis for such recommendation." *Id.* at 597.

A review of applicable industry guidance confirms the long-standing distinction between suitability determinations made by an individual broker under Rule 2310, and "due diligence investigations" performed by a broker-dealer firm. *See, e.g.*, NASD Notice to Members ("NTM") 03-07 (guidance concerning member firm's obligation to conduct appropriate due diligence concerning investments in hedge funds or funds of hedge funds); NASD NTM 03-71 (guidance concerning member firm's obligation to conduct appropriate due diligence concerning certain non-conventional investments such as "asset-backed securities,

distressed debt, and derivative products").[4] Insofar as FINRA amended, modified, or supplemented its rules and issued new guidance subsequent to the relevant time period in this case, they are not applicable here. As Rabinovich, Mayer, and Rogers' expert David Tilkin explained, FINRA issued a "plethora" of new notices to members in connection with its adoption in 2011 of Rule 2111 (*e.g.*, FINRA NTM 11-02, FINRA NTM 11-25, FINRA NTM 12-25, FINRA NTM 12-55) not "because the rules stayed the same. They are there because things changed." FoF ¶ 171.

The securities industry has *never* imposed a generalized duty to "investigate" on individual registered representatives, and no case or industry guidance of which we are aware suggests that registered representatives are required to investigate, verify or independently validate statements in offering materials that they have had no role in drafting or preparing themselves.[5] *See BNP Paribas Mortg. Corp. v. Bank of Am., N.A.*, 866 F. Supp. 2d 257, 268 (S.D.N.Y. 2012) (finding "no duty, under the industry notices and treatise cited . . . to investigate or verify representations made in the PPM absent participation in preparation of the PPM") (citing FINRA NTM 10-22 (Apr. 2010) at 4; Charles J. Johnson & Joseph McLaughlin, *Corporate Finance and Securities Laws* 7-79 (4th ed. 2011 Supp.)). The offering documents,

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[4] Significantly, the NASD confirmed in NTM 03-71 that even the "due diligence" that a member *firm* was to perform – *i.e.*, to gain a reasonable basis for believing that a product might be suitable for at least *some* investors – was in no way equivalent to the responsibilities of an underwriter making an offering to the public. NASD NTM 03-71 at n.3 ("NASD's use of the term 'due diligence' is not intended to equate the responsibilities of a member for its sales conduct obligations with the requirements of an underwriter under Section 11 of the Securities Act of 1933 and Securities Act Rule 176.").

[5] As the record of these proceedings established, the word "investigate" regarding an individual registered representative's responsibility does *not* appear in NASD Rule 2310; and it is *not* used in the federal securities laws, or in any SEC or FINRA rule or regulation. FoF ¶ 178.

prepared by underwriters, are themselves subject to the securities laws and are the starting point for understanding the features of any investment. *See* FoF ¶¶ 167-69.

As at least one opinion of the Commission during the relevant time period makes clear, the "reasonable basis" component of the suitability rule is, in fact, much more basic than the Division has claimed in these proceedings:

> [A] broker may violate the suitability rule if he fails so fundamentally to comprehend the consequences of his own recommendation that such recommendation is unsuitable for *any* investor, regardless of the investor's wealth, willingness to bear risk, age, or other individual characteristics. More commonly, however, the suitability rule will be violated by a recommendation that might be suitable for some investors but is unsuitable for a specific investor to whom the recommendation is directed.

Matter of F.J. Kaufman & Co., File No. 3-6710, 1989 SEC LEXIS 2376, at *11 (Dec. 13, 1989) (Opinion of the Commission). This more limited duty to have a basic understanding of the investment product – as opposed to a duty to investigate or verify – has long characterized the scope of a registered representative's product suitability obligation. *See* FoF ¶ 166; *see also* FoF ¶ 174. And, although the exact scope of a broker's inquiries will vary with the circumstances of the particular investment and the nature of the recommendation made, the relevant standard of care requires registered representatives to have a basic understanding of the features, risks and rewards of the investments that they plan to present to their customers, by learning about the investment, reviewing the offering materials and conducting related industry research or asking any questions where applicable. FoF ¶ 169. Under this standard – the only one applicable in this case – Rabinovich, Mayer and Rogers did all that was required of them under the law.

2. Rabinovich, Mayer and Rogers Fulfilled Their Duties As Registered Representatives

Rabinovich, Mayer and Rogers knew of, and complied with, their obligations and duties as registered representatives. They performed product suitability and client suitability

assessments before offering McGinn Smith Securities to their clients. They knew the due diligence that McGinn Smith and others were performing on the investments. They understood the features, risks and rewards of the investments they were offering. And, they presented them only to clients for whom they were suitable. They more than complied with the obligations of a registered representative. *See generally* FoF ¶¶ 188-234 (Rabinovich), 235-79 (Mayer), 280-310 (Rogers).

In performing their product suitability analysis, Rabinovich, Mayer, and Rogers attended management presentations and asked questions of management. FoF ¶¶ 189, 240-44, 280, 286. They learned about the due diligence that McGinn Smith and others were performing, which, contrary to the Division's claims, was not limited to Smith. Indeed, Smith was assisted by, among others, Tim Welles and Mike Lasch of Pine Street, Scott Weisman, head of McGinn Smith's investment banking, Tom Livingston, head of syndicate, in-house counsel, outside counsel, and outside accountants. FoF ¶¶ 195-99, 245-46, 290-93. At times, Rabinovich himself assisted Smith in reviewing certain deals for the Four Funds, including CMET, Vigilant, and Vidsoft, and Mayer as well participated in due diligence meetings with CMET, Palisades, Pine Street and CMS. FoF ¶¶ 207, 248. Rabinovich, Mayer and Rogers also knew that many of the underlying investments of the Four Funds were underwritten by prominent Wall Street investment banks and audited by reputable accounting firms such as Deutsche Bank, Merrill Lynch, Ernst & Young, and PricewaterhouseCoopers. FoF ¶¶ 200, 247, 290; *see also* FoF ¶ 46.

They also knew of McGinn Smith's long track record in the alarm contract business, backed by an extensive due diligence team. FoF ¶¶ 61-63, 67-71. They knew of Messrs. McGinn and Smith's extensive and accomplished experience as investment professionals and McGinn Smith's more than 20-year track record in the industry. FoF ¶¶ 49-57.

They knew that McGinn Smith had successfully raised $185 million from investors in the Pre-2003 Trust Offerings, many of which were subsequently rolled up into the initial public offering of IASG that was well-received by Wall Street analysts. FoF ¶¶ 58, 76-86.

Both during and after management presentations, Rabinovich, Mayer and Rogers reviewed and analyzed the PPMs for the products that were presented. FoF ¶¶ 189, 192, 235-36, 280, 282. They fully understood the features, risks, and rewards of these investment opportunities, all of which were fully disclosed in the offering documents. *See* FoF ¶¶ 106-27 (Four Funds), 139-56 (Trust Offerings and MSTF). They discussed them with each other and often reached different conclusions, which only further supports the fact that they independently performed their obligations as registered representatives. FoF ¶¶ 283-85.

In performing their customer suitability analysis, Rabinovich, Mayer and Rogers had detailed discussions with clients about their financial picture, investment objectives, risk tolerance, and goals. FoF ¶¶ 191, 237, 281-82. They prepared investment plans for their clients regarding asset allocation, that reflected a diverse portfolio of investments, only a small portion of which was McGinn Smith Securities. *Id.*; *see also* FoF ¶¶ 30 (noting that 90% of Rogers' "business was stocks, bonds, mutual funds, ETFs"), 364 (less than 20% of Rabinovich's client's assets were allocated to McGinn Smith Securities). Where suitable, Rabinovich, Mayer and Rogers presented McGinn Smith Securities to their primarily accredited investor clients. FoF ¶¶ 623-26, 648-51, 667-70. In so doing, they reviewed the offering materials and brought the features, rewards, and risks to their clients' attention, *see, e.g.*, FoF ¶¶ 192-93, 419, 484, all of which were fully disclosed in the PPMs in any event. Indeed, the offering documents for the McGinn Smith Securities contained a wealth of information about the investments, including a statement of the proposed business purpose and use of funds, and a detailed statement of the

known or reasonably ascertainable risks of investing in the issuer or in the private placement securities themselves. FoF ¶¶ 106-27 (Four Funds), 139-56 (Trust Offerings and MSTF); *see also* FoF ¶¶ 604-06, 611-12 (discussing different purposes of the Trust Offerings as described in the PPMs).

Rabinovich, Mayer and Rogers did not "blindly" recommend McGinn Smith Securities, but did so only after a thorough and thoughtful process that was detailed in testimony by Rabinovich, Mayer and Rogers as well as numerous investor witnesses. *See, e.g.*, FoF ¶¶ 374-77 (Stanton Rowe), 425-27 (William Strawbridge), 438-43 (Gary Von Glinow), 489-91 (Abraham Garfinkel). Their practice was far from a "boiler room" operation, and plainly distinct from the cases on which the Division relies. They knew that the interest rates offered on McGinn Smith Securities were neither outlandish nor unreasonable in light of the cost of capital and debt coverage estimates that they learned from Messrs. McGinn and Smith. FoF ¶¶ 196, 241-44, 294. They knew that when liquidity dried up in the second half of 2007, and the economy collapsed in 2008, assets could be purchased at deep discounts, creating opportunities for McGinn Smith private placement offerings. *See, e.g.*, FoF ¶ 230.

Neither Rabinovich nor Mayer nor Rogers knew – and the Division identifies no credible reason they should have suspected – that McGinn and Smith were secretly commingling and diverting funds. FoF ¶¶ 234, 279, 310. While Rabinovich, Mayer and Rogers' trust was ultimately betrayed by McGinn and Smith, Rabinovich, Mayer and Rogers believed in McGinn Smith Securities at the time they offered them, as evidenced by the overwhelming amount of capital raised from their family members, and they believed that McGinn and Smith had the

ability to successfully manage the assets. FoF ¶¶ 367, 420, 481.[6] That trust aside, their own knowledge and due diligence were *more* than sufficient to satisfy their obligation to understand the features, risks and rewards of the products before offering them to their clients.

Yet, even if the Division could establish that they somehow fell short of their obligations (and they did not), the Division did not show that Rabinovich, Mayer and Rogers acted with the requisite intent to hold them liable for fraud. *See Anwar v. Fairfield Greenwich, Ltd.*, 745 F. Supp. 2d 360, 376 (S.D.N.Y. 2010) (finding a duty but nonetheless dismissing Section 10(b) claim for lack of *scienter* upon allegations that investment advisors breached a duty by recommending Madoff fund); *see also BNP Paribas Mortgage Corp.*, 866 F. Supp. 2d at 267 ("to form the basis for liability in damages, the broker's violations of the rules must be 'tantamount to fraud'"). Even a cursory reading of the cases cited by the Division (*see* Division's Post-Hearing Brief ("Div. Br.") at 11-13) reflects that, unlike this proceeding, the securities professionals in those cases *actually intended* to defraud their customers:

Hanly: In *Hanly*, the brokers made specific misrepresentations and reckless omissions that made their outlandish, highly unreasonable one-sided recommendations false and misleading. *See* 415 F.2d 589, 592 ("the Commission held that 'the fraud in this case consisted of the optimistic representations or the recommendations . . . without disclosure of known or reasonably ascertainable adverse information which rendered [the brokers' statements] materially misleading . . . .'"). The brokers in *Hanly* falsely claimed to have purchased the stock they were recommending for their own accounts. *Id.* at 593. They also provided specific

[6] Lest there be any doubt, Rabinovich, Mayer and Rogers' family did not receive any special treatment as investors in McGinn Smith Securities nor were their investments limited to 2004 and 2005. Rabinovich's family invested as late as January 2009, and his father contributed $300,000 to the Firstline "rescue" mission in April 2010. FoF ¶¶ 367, 370. Rogers explained that his family rolled their 2005 investments, which are now in the hands of the Receiver. FoF ¶ 481.

outlandish price predictions: the stock would soon "skyrocket"; it would "go from 6 to 12 in two weeks," or would "double after three or four weeks." *Id.* at 593-95. But the brokers knew the company had no working capital and was operating at a loss, and failed to disclose that information to their customers. *Id.* at 594. No such facts were presented here.

Giesige: In *Giesige*, the broker demonstrated a "flagrant example of fraudulent conduct" that mirrored the outlandish and specific misrepresentations of material fact that the brokers made in *Hanly*, amply supporting a finding of *scienter*. *Matter of Giesige*, File No. 3-12747, 2008 SEC LEXIS 2463, at *69 (Oct. 7, 2008). All of the investor witnesses who testified stated that they invested based on the broker's specific material misrepresentations or omissions which included recommending pre-IPO equity shares of a company the broker found through an internet link and learned about from a company representative she "did not know much or anything" about. *See id.* at *11. In addition – unlike here – the broker's conduct was "inherently fraudulent" because she predicted "specific and substantial increases in the price of a speculative security." *See id.* at *67.

Pinkerton: In *Pinkerton*, the broker made similar outlandish material misrepresentations about the merits of the private placement he offered (*e.g.*, "BFL shares would trade publicly any day," "BFL shares would double from the $3.00 unit offering price") where he had no basis to make those claims and where the documents attached a "highly irregular and nonsensical" audit letter that suggested the product was a sham and – unlike here, where the ownership and control of the McGinn Smith Securities was fully disclosed in each PPM – the broker failed to disclose the relationship between his broker-dealer and the product that he was recommending. *Matter of Pinkerton*, File No. 3-8805, 1996 SEC LEXIS 3067, at *17, *18, *23 (Oct. 18, 1996).

Stires: In *Stires*, the president of a broker-dealer knew that (i) institutional investors were not purchasing these securities due to the lack of documentation surrounding them, (ii) an attorney with no firm affiliation would not provide documentation about the transaction, and (iii) extremely basic and obviously significant questions about the transaction, such as the identity of the supposed "European insurance syndicate" who purportedly issued the securities, went unanswered. *Matter of Stires*, File No. 3-9120, 1998 SEC LEXIS 1698, at *20-21, *24-26 (Aug. 11, 1998). Yet, the respondent continued to solicit investors to purchase the securities, despite receiving a letter indicating that the investment was a "suspicious, non-confirmable, non-transparent or not readily understood arrangement." *Id.* at *26.

The Division's remaining case law is equally inapplicable. *See* Div. Br. at 9-11. In *SEC v. Hasho*, the defendants "operated a boiler room operation; they recommended speculative securities to mostly unsophisticated investors using high pressure and fraudulent sales pitches via long distance telephone solicitations." 784 F. Supp. 1059, 1107 (S.D.N.Y. 1992). In *SEC v. Platinum Inv. Corp.*, the defendant was "undoubtedly reckless" because he "failed to take even the most rudimentary steps to make sure his recommendations to his clients were responsible and reasoned," "did nothing to confirm his price or performance predictions," "did nothing to familiarize himself with private placements," and failed even to read the materials going to his customers. *Platinum*, 02 Civ. 6093, 2006 U.S. Dist. LEXIS 67460, at *8, 12, 16 (S.D.N.Y. Sept. 20, 2006). Finally, in *SEC v. Milan Capital Group, Inc.*, the defendant-broker enabled the sale of phony IPO securities that were obviously a sham. *Milan*, 00 Civ. 108, 2000 U.S. Dist. LEXIS 16204, at *5-6, *13-21 (S.D.N.Y. Nov. 9, 2000).

In sum, the Division has presented no evidence that would establish that Rabinovich, Mayer and Rogers evinced an actual intent to defraud or engaged in conduct so

unreasonable that it "represent[ed] an extreme departure from the standards of ordinary care." *Rolf*, 570 F.2d at 47. To the contrary, they were diligent, they were informed, and they dealt fairly with their clients. Simply put, they were the victims – not the perpetrators – of any fraud.

C. There Were No Red Flags That Would Have Altered Rabinovich, Mayer and Rogers' Duties In the Manner Suggested by the Division

Despite the Division's ever-growing list of supposed "red flags," *see* FoF ¶¶ 355-59, the evidence did not establish that there were any "red flags" that would have varied Rabinovich, Mayer and Rogers' duties in the manner or to the extent that the Division claims. The Division now asserts that there were "ten categories of red flags that [Respondents] should have investigated and resolved prior to recommending the [McGinn Smith] offerings to their customers," *see* Div. Br. at 18, but nowhere in its post-hearing brief is any definition of what, under the law, constitutes a red flag in the first instance. This glaring omission alone is fatal to the Division's Fraud Claim.

The Division's proffered expert, Robert Lowry, defined a "red flag" as "a warning or *notice of potential concerns or violations of the securities laws* that require a heightened response and investigation." FoF ¶ 177 (emphasis added). Relatedly, a showing of *scienter* based on red flags must include facts showing both that (1) the defendant was actually aware of the alleged flags, and (2) that the flags were "so obvious[ly]" indicative of fraud "that the defendant must have been aware of [the fraud]" and desirous of furthering it. *See South Cherry*, 573 F.3d at 109, 112; *Stephenson v. Citco Group Ltd.*, 700 F. Supp. 2d 599, 622-23 (S.D.N.Y. 2010); *see also MLSMK Invs. Co. v JP Morgan Chase & Co.*, 737 F. Supp. 2d 137, 145 (S.D.N.Y. 2010) (finding allegations of *scienter* insufficient because "[w]hile it may be true that Defendants could have connected the dots to determine that Madoff was committing fraud, Plaintiff offers no facts to support the claim that they actually reached such a conclusion"); *In re*

J.P. Jeanneret Assocs., 769 F. Supp. 2d 340, 365 (S.D.N.Y. 2011) (mere "existence of 'red flags' does not satisfy the *scienter* requirement").

The Division failed to establish that the "red flags" identified in the OIP – the only "red flags" that may be properly considered now – were even "red flags" or that Rabinovich, Mayer and Rogers knew of them. There were certainly no "red flags" suggesting a wide-ranging unbounded "duty to investigate" every aspect of McGinn Smith's business operations including the *bona fides* of all 26 private placement offerings mentioned in the OIP between 2003 and 2009.

In an analogous context, the Second Circuit recently affirmed that an auditor's failure to discover a fraudulent scheme amid purported "flags" – including that related parties shared the same management and received money from each other's investors – could not support a finding of *scienter* because they were not so obviously indicative of fraud that the defendant must have been aware of the fraud and desired to further it – even under circumstances where (unlike here) the SEC later "easily" discovered the scheme. *See Iowa Pub. Employees Ret. Sys. v. Deloitte & Touche LLP*, 919 F. Supp. 2d 321 (S.D.N.Y. 2013), *aff'd*, 2014 U.S. App. LEXIS 4918, at *3-4 (2d Cir. Mar. 17, 2014). The district court's analysis of the issues in *Deloitte & Touche* is instructive:

> To assume that since the SEC, when it examined both WGTC and WGTI, found evidence of a Ponzi scheme, so too should have D&T, when auditing WGTC's financials, discovered and reported the fraud, is to lean heavily on the correlative power of hindsight. And in the context of 10b-5, courts have repeatedly stated that corporate officers are not expected to be "clairvoyant" . . . . Plaintiff's suggestion that the SEC investigation necessarily reveals D&T's mindset rests on a *post hoc ergo propter hoc* approach to the complex issue of *scienter*.

Id. at 334-35.

Likewise, evidence of disclosed conflicts of interest, disclosed investments in affiliates, or exclusive control over an investment program are insufficient to support an inference of *scienter*. *See Stephenson v. PricewaterhouseCoopers, LLP*, 768 F. Supp. 2d 562, 574-75 (S.D.N.Y. 2011) (dismissing claim based on auditor's mere access to information by which it could have discovered warning signs and noting that "flags are not red merely because the plaintiff calls them red"); *Anwar*, 728 F. Supp. 2d at 453 (fact that "all of the Funds' assets were managed by Madoff . . . with no checks and balances" was not a "flag" that supported an inference of *scienter*).

No case or industry guidance requires the investigation that the Division hypothesizes should have occurred, especially given the facts adduced here.

1. The PPMs Contained Standard Disclosures

The Division did not present any evidence that the disclosures in the PPMs for McGinn Smith Securities were anything other than ordinary or customary in the industry. In fact, as a comparison to the PPMs for other McGinn Smith private placements not at issue in the OIP makes clear, the alleged "red flag" disclosures cited by the Division are typical. FoF ¶ 311; *see also* RMR Ex. 861, attached to the FoF as Demonstrative Exhibit A. The Division's claims to the contrary are unsupported by the law and even its own expert's definition of a red flag. *See South Cherry*, 573 F.3d at 109 (red flag must be "so obvious[ly]" indicative of fraud "that the defendant must have been aware of [the fraud]" and desirous of furthering it); FoF ¶ 177 (red flag is "a warning or notice of potential concerns or violations of the securities laws that require a heightened response and investigation").

As each of Rabinovich, Mayer and Rogers testified, the disclosures made in the Four Funds PPMs that they were newly formed entities, that related entities participated in the offering, that affiliated transactions could occur, and that management had not previously

managed the specific type of fund were commonplace. FoF ¶¶ 313-15. Nor did the PPMs' disclosure of Smith's ownership and control of the Four Funds raise a red flag as this too was typical in private placements. *Id.*

Tilkin and Lex's expert, Charles Bennett, both seasoned veterans of the securities industry, echoed this testimony. Tilkin explained that conflicts of interest disclosed in a PPM do not heighten the registered representatives' obligations, because they were fully disclosed and a "conflict of interest relative to issuers being affiliated with broker-dealers is almost a daily event. That is what broker-dealers do . . . ." FoF ¶ 316. Bennett also noted that affiliations between issuer and underwriter in the offer of proprietary product sales "happens all the time." FoF ¶ 317. Tilkin also did not regard Smith's level of control over the Four Funds to be of any great significance because McGinn and Smith were seasoned veterans in the capital markets, and Smith had sufficient experience and background in underwriting to launch private placements such as the Four Funds. FoF ¶ 318; *see also* FoF ¶¶ 49-57.

In addition, the "affiliated transactions" disclosure that the Division calls into question represents a *protective limitation* on the potential conflict of interest – *not* a cause for concern. The PPMs' expressly stated that "we will not pay above the price paid by our managing member or such affiliate for the Investment." FoF ¶ 123. That Smith secretly did otherwise was unknown to Rabinovich, Mayer and Rogers, and they had no reason, at the time, to question the statements in the PPMs. FoF ¶¶ 234, 279, 310.

Moreover, the Four Funds cannot be fairly classified as securities "issued by smaller companies of recent origin." *See* FoF ¶ 318. Though "technically" new issuers, the Four Funds were sponsored by a firm that had been in business since 1980 with some 35 to 50 registered representatives and great success in the securities markets. FoF ¶¶ 41, 49-86, 319.

Rabinovich, Mayer and Rogers knew that history and understood the Four Funds and Trust Offerings. *See* FoF ¶¶ 188-234 (Rabinovich), 235-79 (Mayer), 280-310 (Rogers).

Further, insofar as the Division contends that the broad investment mandate of the Four Funds was "different" than the Pre-2003 Trust Offerings and therefore required some unspecified measure of "greater diligence," *see* Div. Br. at 18, Rabinovich, Mayer and Rogers testified at length about the work they performed to understand the underlying investments by the Four Funds – which was entirely sufficient. FoF ¶¶ 195-217 (Rabinovich), 240-63 (Mayer), 286-300 (Rogers). Moreover, Smith's purported inadequate background or experience to manage investments of the size or scope of the Four Funds is belied by the evidentiary record. FoF ¶¶ 49-86.

Finally, the disclosures in the Four Funds' PPMs did not, and could not, raise a "red flag" regarding the Trust Offerings. Indeed, the Trust Offerings were similar in structure and purpose to the successful Pre-2003 Trust Offerings, that had been a focus of McGinn Smith's business for years. FoF ¶¶ 58-75; *see also* FoF ¶ 273. The Trust Offerings did not have broad investment mandates, but instead specific, fully disclosed purposes (and fully disclosed fee and expense structures). FoF ¶¶ 147-54, 604-06, 611-12. And, the PPMs made the same disclosures regarding due diligence as the Pre-2003 Trust Offerings, such as Security Participation Trust, which Cody drafted, and had raised no cause for concern. FoF ¶ 312.

Unlike the cases the Division offers, which do not even apply to a broker's duty of care, no evidence was presented that "raised enough questions" for Rabinovich, Mayer and Rogers to doubt the representations in the PPMs. The Division failed to present evidence that they should have "asked for information on *all* affiliated transactions and *demanded* to know

whether the price restrictions were observed." *See* Div. Br. at 19 (emphasis added).[7] That kind of inquiry would transform these registered representatives into accountants or private investigators, under circumstances where they had no reason to doubt the conduct of their employer in designing and offering these securities for sale. No case has imposed such a duty.

2. Rabinovich, Mayer and Rogers Were Not Denied Information Concerning the Four Funds

Whatever evidence the Division may have presented that Smith concealed the Four Funds' investments from *some* brokers, there was *no* evidence that Smith concealed information requested by Rabinovich, Mayer, and Rogers. Smith frequently discussed with Rabinovich the "types of investments he was making, both specific investments and specific sectors," and he was *not* reluctant to provide Rabinovich, Mayer or Rogers with specific information about the Four Funds' investments other than the names of a few small loans to local Albany companies. FoF ¶¶ 320-28. Each of Rabinovich, Mayer and Rogers testified in detail about the various investments made by the Four Funds of which they were aware. Contrary to the Division's assertion that the Four Funds' investments were "concealed," FIIN's investments were disclosed in Pine Street's 2004 investor presentation. FoF ¶ 190. That Smith allegedly "concealed" from Rabinovich, Mayer and Rogers how he invested Four Funds proceeds is not a "red flag." It is a fiction.

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[7] The Division's cases on this point are totally inapposite and mostly discuss accounting duties of investigation and verification. *See McCurdy v. SEC*, 396 F.3d 1258 (D.C. Cir. 2005) (negligence case concerning auditor's review of a public company's books); *In re Bear Stearns Cos., Inc. Sec., Derivative, & ERISA Litig.*, 763 F. Supp. 2d 423 (S.D.N.Y. 2011) (investment bank's failure to comply with GAAP accounting); *In re Am. Preferred Prescription, Inc.*, 893-84170, 1997 Bankr. LEXIS 387, at *14 n.11 (Bankr. E.D.N.Y. Mar. 21, 1997) ("[r]elated party transactions require close scrutiny by *auditors*") (emphasis added).

3. Rabinovich, Mayer and Rogers Were Unaware of Any Purported Redemption "Policy"

Contrary to the Division's assertion, McGinn Smith did not announce a "policy" in December 2006 that clients only could redeem their investment in a Four Funds note if their brokers first found a replacement investor. FoF ¶ 329. Neither Rabinovich, nor Mayer, nor Rogers was told this by anyone in December 2006 or in 2007. FoF ¶ 333 (Rabinovich: "[I]t was never a condition that I had to find a new investor before a client could be redeemed."); ¶ 336 (Mayer: "[N]o one had to do anything" before an existing investor could redeem); ¶ 337 (Rogers never heard of such a policy). Their clients redeemed their Four Funds notes and Trust Offerings certificates, and timely received interest payments from 2003 through 2007. FoF ¶¶ 334, 336, 337.

Tellingly, the Division did not introduce a single email or document into evidence that established Rabinovich, Mayer or Rogers knew about or were told about a redemption policy. FoF ¶ 330.[8] Rather, during 2003 through 2009, McGinn Smith tried to make a secondary market – match a buyer and a seller to trade a security – which was not a red flag, but rather an accommodation, as the PPMs stated the private placement investments were illiquid. FoF ¶ 332.[9]

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8 Rabinovich did not, as the Division falsely claims, replace a client's TAIN redemption in December 2006 at Smith's direction. *See* Div. FoF ¶¶ 626-28. Not only was Rabinovich not copied on Smith's email, but as he testified, he was not aware of, and had nothing to do with, the subsequent sale to Shukriya Bhandari. FoF ¶ 335.

9 Any difficulty that may have been experienced in redeeming clients in late 2007 and 2008 is unsurprising given the Great Recession of 2008. *See* FoF ¶ 339 & n.5. But, there was never any redemption "policy" of which Rabinovich, Mayer or Rogers were aware.

4. The January 2008 Meeting Was Unsurprising Given the Economic Downturn that Impacted the Entirety of the Global Markets

At a meeting in Albany in January 2008, McGinn and Smith informed brokers that interest on the junior notes of the Four Funds would be reduced. FoF ¶ 338. The other tranches in the Four Funds were *not* affected. *Id.* As the testimony at trial unequivocally established, 2007 and 2008 represented a "fundamental disruption – a financial upheaval, if you will – that wreaked havoc in communities and neighborhoods across the country. . . . Businesses, large and small, have felt the sting of a deep recession." FoF ¶ 339. With this backdrop, the January 2008 meeting could hardly be viewed as a red flag.

The stock market, alternative investments and financial institutions declined precipitously during the Great Recession. The reduction of interest on the junior notes was not indicative of any fraud. Smith went over specific investments, and identified where there was stress on the portfolio. FoF ¶ 340. McGinn talked about undertaking additional revenue initiatives to shore up some of the problems in the Four Funds. *Id.* Notably, the impairments discussed at the January 2008 meeting had nothing to do with the Trust Offerings. FoF ¶ 338.

Rabinovich, Mayer and Rogers were all unhappy and disappointed about the news, but they did not consider it a red flag given the economic climate at the time. FoF ¶¶ 342, 344, 346. Rabinovich knew that other funds suffered impairments and that there was stress in the subprime mortgage market. FoF ¶ 342. Mayer knew that numerous, similar investments were suffering impairments, such as Deerfield and GSC in which the Four Funds had invested. FoF ¶ 344. And, Rogers was well aware that the global financial liquidity crisis was affecting "all sorts of assets." FoF ¶ 346. All three Respondents thought that the restructuring plan proposed at the January 2008 meeting could succeed, and they promptly informed their junior note clients of the news. FoF ¶¶ 342-43 (Rabinovich), 344-45 (Mayer), 347-48 (Rogers).

5. Rabinovich, Mayer and Rogers Were Unaware of the Firstline Bankruptcy Until After They Ceased Presenting McGinn Smith Securities to Their Clients

The final red flag alleged by the Division – McGinn and Smith's failure to tell brokers of the Firstline bankruptcy until September 2009 – was indeed a cause for concern. Yet, neither Rabinovich, Mayer or Rogers presented McGinn Smith Securities after learning of McGinn and Smith's failure to timely disclose the information. FoF ¶¶ 351-53.

The Division admits that Rabinovich, Mayer, and Rogers were unaware of the Firstline bankruptcy before September 2009. FoF ¶ 350. As the evidence demonstrated, they ceased presenting McGinn Smith Securities to their clients at that time and left McGinn Smith to form RMR Wealth Management. FoF ¶¶ 351-54. It is undisputed that Rogers presented no McGinn Smith Securities to his clients after September 1, 2009. FoF ¶ 353. And, although the Division's sales charts purport to show that Rabinovich and Mayer each presented Trust Offerings to a total of three customers after learning of the bankruptcy, the evidence showed otherwise. Rabinovich had presented the investments and his clients had signed the subscription agreements, in August 2009 before learning of the bankruptcy. FoF ¶ 351. As the signed subscription agreement for Mayer's single sale makes clear, he presented Benchmark to Vincent O'Brien in August. FoF ¶ 352.

D. Rabinovich, Mayer and Rogers Did Not Make Any Material Misrepresentations or Omissions To Their Clients

The Division failed to establish evidence of any material misrepresentation or omission of a material fact by Rabinovich, Mayer or Rogers. The record confirms that Rabinovich, Mayer and Rogers dealt fairly with, and made full and accurate disclosures to, all of their clients. In any event, the Offering Documents, which were reviewed and then signed by

every investor who testified at the hearing (as well as those who did not testify), undermine any claim to the contrary. FoF ¶¶ 130-31 (Four Funds), 157-60 (Trust Offerings and MSTF).

No claim under Section 10(b) and Rule 10b-5 is available without proof that a defendant: "(1) made a material misrepresentation or a material omission as to which he had a duty to speak, or used a fraudulent device; (2) with *scienter*; (3) in connection with the purchase or sale of securities." *E.g.*, *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999); *see also Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) ("the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it"). Similarly, no claim under Section 17(a)(1) for employing any "device, scheme or artifice to defraud" is available without proof of *scienter*. *See Aaron*, 446 U.S. at 696.

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making a decision to invest, and an omission that makes a statement misleading is only material if a reasonable investor would consider its disclosure to have significantly altered the "total mix" of information available. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). "Materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information" and represents a highly fact-specific inquiry. *See id.* at 240. "It is not enough that a statement is false or incomplete, if the misrepresented fact is otherwise insignificant." *Id.* at 238. Likewise, not all omitted facts or failures to disclose are actionable. *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000) ("Corporate officials need not be clairvoyant; they are only responsible for revealing those material facts reasonably available to them . . . . [A]llegations that defendants should have

anticipated future events and made certain disclosures earlier than they actually did do not suffice to make out a claim of securities fraud.").

Notably, in the context of a broker's investment recommendations, generic statements of opinion that securities are "safe" or "solid" investments are both (1) immaterial and (2) not sufficiently factual to qualify as evidence of a material misrepresentation or omission of material fact. For example, in *Ashland, Inc. v. Oppenheimer & Co.*, the Sixth Circuit found that a broker's purported misrepresentations that auction rate securities were "safe and secure" were not actionable because they were too vague to be material, stating "such a soft description escapes objective verification." 648 F.3d 461, 468 (6th Cir. 2011) (citation omitted). Numerous courts have found that "loosely optimistic statements that are so vague, so lacking in specificity, or so clearly constituting the opinions of the speaker" are immaterial because "no reasonable investor could find them important to the total mix of information available." *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1217 (1st Cir. 1996); *see also Nathenson v. Zonagen, Inc.* 267 F.3d 400, 404, 419 (5th Cir. 2001); *Lasker v. N.Y. State Elec. & Gas Corp.*, 85 F.3d 55, 58 (2d Cir. 1996). Courts have routinely dismissed Section 10(b) claims upon arguments that brokers misrepresented securities as "safe," "well-collateralized" or otherwise solid investments as too vague to be actionable. *See Ashland*, 648 F.3d at 468; *Peoples State Bank v. Stifel Nicolaus & Co., Inc.*, 10 Civ. 1640, 2013 U.S. Dist. LEXIS 35161, at *32 (S.D. Ind. Mar. 14, 2013) (misrepresentations that auction rate securities "were 'safe,' 'well-collateralized,' and 'represented student loan receivables guaranteed by the federal government'" were "too vague and imprecise to qualify as material"); *In re Merrill Lynch Auction Rate Sec. Litig.*, 851 F. Supp. 2d at 529 ("When adequate disclosures are made, it cannot be said that a defendant's conduct is

'highly unreasonable and represents an extreme departure from the standards of ordinary care.'").

Moreover, where, as here, a party argues that brokers omitted to disclose information that was provided in the prospectus or private placement memorandum, such claims are legally deficient – because the supposed "disclosure" does not "significantly alter" the "total mix" of information already available to a reasonable investor. The purported "omissions" fail for immateriality and lack of *scienter*. *See La Pietra v. RREEF Am., L.L.C.*, 738 F. Supp. 2d 432, 441 (S.D.N.Y. 2010) (a reasonable investor is held responsible "for knowledge of the disclosures in a fund's prospectus" which is considered part of the "total mix" of available information); *cf. Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1032 (2d Cir. 1993) (describing a prospectus as "the single most important document and perhaps the primary resource an investor should consult in seeking" information on an investment's risks).

The Division failed to prove a single material misrepresentation or omission by Rabinovich, Mayer or Rogers in connection with the purchase or sale of any security at issue in this case. There was none.

1. Phil Rabinovich

The Division contends that Rabinovich made material misrepresentations to clients in his letters and emails regarding FEIN. *See* Div. Br. at 28. These letters were sent to ten investors, only two of whom actually invested in the Four Funds: Stanton Rowe and Michael Favish. FoF ¶ 362. Both Rowe and Favish flew to New York from California to testify about Rabinovich's conduct and integrity. FoF ¶ 375 (Rowe: Rabinovich "was always thorough and honest and straightforward in his dealings with me and I valued that relationship and I still do."); FoF ¶ 388 (Favish: "I have known Mr. Rabinovich for a very long time and all my dealings with him have been very respectful. They have been very honest in my opinion. . . . I will continue to

believe in him."). It is difficult to envision a scenario less indicative of fraud. The other recipients did not invest or testify. FoF ¶ 362.

The testimony of Ketan Patel and Patricia Chapman did not present any material misrepresentations or omissions. *See* FoF ¶¶ 398-408 (Patel findings); FoF ¶¶ 409-15 (Chapman findings).

2. Brian Mayer

Mayer similarly made no material misrepresentation or omission of material fact with *scienter* to any of his clients. Vincent O'Brien's testimony that he thought McGinn Smith Securities were "safe" and that Mayer failed to disclose certain information regarding fees and expenses of the Trust Offerings are insufficient to establish a fraud claim. O'Brien's hazy testimony (*see* FoF ¶ 457) was far too vague to be actionable. *See Ashland*, 648 F.3d at 468. Further, O'Brien admitted that he received, reviewed, and then signed the Offering Documents, in which he expressly disclaimed his reliance on any alleged representations by Mayer. Moreover, the Offering Documents expressly provided the information that O'Brien claimed was not disclosed. *See* FoF ¶¶ 139-56; *see also La Pietra*, 738 F. Supp. 2d at 441.

Tellingly, O'Brien testified that before making any investment, Mayer told O'Brien about McGinn Smith in general, and that Mayer wanted to "sketch out" an investment strategy for him in a variety of asset classes including "stocks, bonds and so on." FoF ¶ 455. The documentary evidence reflects that Mayer and O'Brien built a diversified portfolio of investments. FoF ¶ 456. If anything, O'Brien's testimony demonstrates that Mayer acted in his best interests, and not with any intent to defraud him.

The Division did not present evidence of "other examples" of supposed material misrepresentations or omissions with respect to Gary Von Glinow or Thomas Alberts, both of whom did not even purchase a security at issue in the OIP after 2007. *See* Div. Br. at 28. FoF

¶¶ 562-63 (reflecting staleness of the Division's testimony). Alberts did not identify any misrepresentations or omissions by Mayer and could not even recall key details of the transactions that he made at McGinn Smith in 2006 and 2007 (including, for example, whether he even spoke with Mayer or with his prior broker Christopher Rowe about the transactions). FoF ¶ 468.

Von Glinow, although called as a Division witness, established that Mayer did not defraud him. Von Glinow testified that he found Mayer to be an honest broker and did "a lot of good things . . . for our family." FoF ¶ 450. Mayer's recommendations to Von Glinow – such as to sell Biodel after the stock price had increased dramatically – reflected concern for maintaining and increasing the value of Von Glinow's portfolio. FoF ¶ 439 (concerning Biodel "[h]ad we not followed [Mayer's] advice, it would have come all the way back down to 2 or $3 without our having taken a profit"). Mayer typically called Von Glinow to describe the structure of the investment, how it worked, and how it would pay off, and if Von Glinow was interested, Mayer would send a numbered private placement memorandum that Von Glinow would read and then discuss further with Mayer before investing. FoF ¶ 438. Von Glinow often had "30 or 50, 70 questions on each one of these [private placement] memoranda," and Mayer could answer "almost all" of them. *Id.*

3. Ryan Rogers

Rogers also made no material misrepresentation or omission of material fact with *scienter* to any of his clients. The Division contends that Rogers told Stephen Fowler that his investments in McGinn Smith Securities were "safe." *See* Div. Br. at 29. Although too vague to be actionable, *see Ashland*, 648 F.3d at 468, the Division's characterization of Fowler's testimony is not accurate. Fowler described his risk tolerance as "high," and testified that he "typically" discussed the risks disclosed in the PPMs. FoF ¶¶ 498-99. Contrary to the

Division's contentions, Fowler did not state that Rogers failed to tell him about the Benchmark fee and expense structure. Rather, he testified that he could not recall that discussion, and admitted that he "would have had a discussion about risks and expenses," *see* FoF ¶ 499, all of which were fully disclosed in the PPMs. FoF ¶¶ 150-51. Any fair reading of Fowler's deposition transcript demonstrates that his testimony was favorable to Rogers. *See* FoF ¶¶ 502-03 (Fowler "built up a very trusted relationship" with Rogers, who he described as "up front"; Fowler is still a client of Rogers today).

Peggy LoScalzo and non-investor James LoScalzo also did not testify about any material misrepresentations or omissions by Rogers. Not surprisingly, the Division fails to identify any alleged misstatements or omissions in its post-hearing brief. *See* Div. Br. at 29. As their testimony showed, Rogers did anything but intend to defraud the LoScalzos. FoF ¶¶ 506-11. He even offered to personally pay back $23,000 on her single $25,000 investment, an offer that was rejected by Jim LoScalzo as "bullshit," and followed by an online campaign to disparage Rogers. FoF ¶¶ 512-13, 519-21.

E. Rabinovich, Mayer and Rogers Have Acted, At All Times, in Their Clients' Best Interests

The evidence conclusively established that Rabinovich, Mayer and Rogers acted, at all times – including after leaving McGinn Smith in late 2009 – in their clients' best interests. The investors called by Rabinovich, Mayer or Rogers – all of whom remain their clients to this very day – testified convincingly and in detail as to their relationships and experience with them, and their basis for believing in their integrity and diligence throughout 2003 through 2009, and since then. FoF ¶¶ 371-97 (Rabinovich), 421-33 (Mayer), 485-93 (Rogers). Their testimony confirmed that Rabinovich, Mayer and Rogers dealt with them fairly, honestly and in good faith. *Id.*

Rabinovich investor Michael Kogan explained that the losses in the markets in 2007 and 2008 took everyone by surprise and that Rabinovich remained a man of honesty and integrity. FoF ¶¶ 395-97. Mayer investor William Strawbridge singled out Mayer's care and detail-oriented nature: "I have multiple accounts with other brokers and I find Brian to be probably the most conscientious and analytical of any of the brokers that I deal with." FoF ¶ 433. Rogers investor Abraham Garfinkel found Rogers "very respectful" and "willing to discuss" Garfinkel's investment objectives; what stood out about Rogers was his "total lack of pushing me towards a specific investment such as the typical stock *du jour*." FoF ¶ 489. Other clients showed their support and belief in Rabinovich, Mayer and Rogers by submitting affidavits. FoF ¶¶ 689, 696, 701. And still others told the Division that they had not been misled by Rabinovich, Mayer or Rogers. FoF ¶¶ 688, 694-95, 700.

The evidence also established that Rabinovich, Mayer and Rogers continued to act in their clients' best interests even after departing McGinn Smith in late 2009, and went to extraordinary lengths to protect them. They (1) found a new custodian for their clients; (2) updated clients about the Receiver and helped liquidate investments held by the Receiver; and (3) helped their clients seek assistance from elected officials and recovery against third parties. FoF ¶¶ 523, 538-44. Rabinovich, Mayer and Rogers not only fulfilled their obligations as registered representatives to understand the products and their customers, they went beyond what was required of them.

F. The Division's Scheme Liability Gambit Fails

The Division failed to present evidence of a scheme liability claim against Rabinovich, Mayer or Rogers. *See* Div. Br. at 30. It is well-settled that a claim under Rule 10b-5 (a) or (c) is legally deficient unless there is proof of inherently deceptive conduct that is separate and distinct from alleged misrepresentations or omissions. *See, e.g.*, *SEC v. Kelly*, 817

F. Supp. 2d 340, 344 (S.D.N.Y. 2011). Rabinovich, Mayer and Rogers cannot be liable under Section 10(b) for conduct in furtherance of statements in the PPMs that others drafted. *See Janus Capital Group*, 131 S. Ct. at 2302 ("If persons or entities without control over the content of a statement could be considered primary violators who 'made' the statement, then aiders and abettors would be almost nonexistent."). Unsurprisingly, the Division fails to support its alternative theory with citation to a single finding of fact. Rabinovich, Mayer and Rogers dealt fairly with their customers and engaged in no scheme to defraud them.

G. The Division Failed To Present Evidence Establishing The Elements of Section 17(a)(2) and 17(a)(3)

The Division's negligence claim under Securities Act Section 17(a)(2) or (3) was not supported by the evidence. Section 17(a)(2) makes it unlawful for a person "to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2). Like the Section 10(b) claim, this claim also fails because the Division failed to present evidence of a material misstatement or omission of material fact (made with *scienter* or negligently) by Rabinovich, Mayer or Rogers. Section 17(a)(3), which makes it unlawful for a person "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser," 15 U.S.C. § 77q(a)(3), fails because no evidence was presented that goes beyond the allegations of supposed misstatements or omissions.

The Division's Section 17(a)(2) and (3) cases (Div. Br. at 30-31) are inapplicable because they hold that only the "*makers*" of statements who engage in fraudulent practices or who "obtain money or property" by means of a material misstatement are covered by these provisions. *See Janus Capital*, 131 S. Ct. at 2302; *see also Matter of Flannery & Hopkins*, File

No. 3-14081, 2011 SEC LEXIS 3835, at *110 (Oct. 28, 2011) ("I find the *Janus* test to be the appropriate standard to apply [to Section 10(b) and 17(a) claims] . . . . Therefore, with respect to allegations involving documentary evidence, the Division must establish that Respondents' had ultimate authority and control over such documents.").

II.

THE DIVISION'S SECTION 5 CLAIMS SHOULD BE REJECTED

The evidence conclusively established that the Division's Section 5 Claim as against Rabinovich, Mayer and Rogers fails for several reasons. First, the Division's integration theory fails, both under the six-month safe harbor and the five-factor test of Rule 502(a), and in the absence of integration, the Division admits that none of the Trust Offerings had more than 35 unaccredited investors. *See* OIP ¶ 32. Second, all of the offerings are exempt from registration under Rule 506 of Regulation D. Finally, Rabinovich, Mayer and Rogers took all reasonable steps to avoid violating Section 5, any purported violation is either *de minimis*, time-barred, or both, and there is no authority for the proposition that an individual broker should be held liable under these circumstances.

A. The Division's Integration Theory Fails

The Division admits that none of the Trust Offerings had more than 35 unaccredited investors (OIP ¶ 32), and implicitly admits that each Trust Offering was exempt from registration. The Division instead argues that eight separate and distinct Trust Offerings (the fictitious TDM Conduit) and six separate and distinct Trust Offerings (the fictitious MSF Conduit) should be integrated and treated as if each "Conduit" were but one offering for purposes of evaluating its Section 5 Claim. The Division's integration argument fails on two accounts.

1. The Trust Offerings Cannot be Integrated Because of the Six-Month Safe Harbor

Rule 502(a), which the Division's Section 5 summary witness admittedly did not consider (FoF ¶ 592), expressly provides that "[o]ffers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D." 17 C.F.R. § 230.502(a).

Within the fictitious TDM Conduit, there is a *fourteen*-month gap between the termination of the offering period for the latest of the first three Trust Offerings (*i.e.*, TDM Luxury Cruise offering ends "not later than" September 16, 2007), and the commencement of the offering period for the earliest of the last five Trust Offerings (*i.e.*, TDM Cable Trust 06, 10% offering begins November 17, 2008). FoF ¶¶ 594, 596. Similarly, within the fictitious MSF Conduit, there is an *eight*-month gap between the termination of the offering period for the latest of the first five Trust Offerings (*i.e.*, TDM Verifier Trust 08 offering ends "not later than" April 30, 2008), and the commencement of the offering period for the next and last Trust Offering (*i.e.*, TDM Verifier Trust 09 offering begins December 15, 2008). FoF ¶¶ 599, 601. Thus, Rule 502(a) mandates that those Trust Offerings in each of the fictitious Conduits whose offering period ended more than six months prior to the start of the offering period for the remaining Trust Offerings in those fictitious Conduits "*will not be considered part of*" the same offering. 17 C.F.R. § 230.502(a) (emphasis added). There are fewer than 35 allegedly unaccredited investors within each of those groupings. FoF ¶¶ 595, 597, 600, 602. The analysis should end here.

The Division, in its post-hearing brief, conflates the six-month safe harbor in the *text* of Rule 502(a), with the five-factor test in the *notes* to the rule. *See* Div. Br. at 6 ("Courts have integrated offerings not made at the same time where, as here, the other factors weigh heavily in favor of integration."). This is incorrect. As the notes to Rule 502(a) provide, the five-factor test is considered only "*[i]f* the issuer offers or sells securities for which the safe harbor rule in paragraph (a) of this § 230.502 is *un*available." *See* Notes to 17 C.F.R. § 230.502(a) (emphasis added). When the *text* of the rule is properly considered, separate and apart from the five-factor test in the *notes* to the rule, integration is unavailable. The Division all but admits as much. *See* Div. Br. at 6-7 ("there is a six-month, three-week gap between sales in the TDM Conduit").[10]

2. The Trust Offerings Cannot be Integrated Under the Five-Factor Test

The Trust Offerings also cannot be integrated under the five-factor test in the notes to Rule 502(a). The five-factor test considers "(a) Whether the sales are part of a single plan of financing; (b) Whether the sales involve issuance of the same class of securities; (c) Whether the sales have been made at or about the same time; (d) Whether the same type of consideration is being received; and (e) Whether the sales are made for the same general purpose." *See* Notes to 17 C.F.R. § 230.502(a). Applying these factors, there is no basis to integrate the separate Trust Offerings within the fictitious Conduits.

First, there was no single plan of financing, nor were the sales made for the same purpose. To the contrary, the separate Trust Offerings raised money for various purposes, including investments in triple-play contracts, security alarm contracts, and luxury cruise

[10] While the Division contends that "[s]ales of MSF Conduit certificates were never more than six months apart," *see* Div. Br. at 6, this ignores the express terms of the PPMs, which set the parameters of the offering periods.

receivables, and the Receiver and the Division have both admitted as much. *See* FoF ¶¶ 604-06, 611-12. Moreover, insofar as more than one Trust Offering invested in the same type of asset, such as triple-play or security alarm contracts, they did so in different communities and on different terms. *Id.* These two factors alone weigh heavily against integration. *See Donohoe v. Consol. Operating & Prod. Corp.*, 982 F.2d 1130, 1140 (7th Cir. 1992) (affirming district court's decision rejecting integration where "factors a and e pushed strongly the other way").

In *Donohoe*, the separate offerings that the plaintiff sought to integrate all invested in drilling projects, but each "raised money for a discrete, identifiable set of wells." *Id.* The court concluded that where, as here, "each drilling project [i.e., offering] was designed to stand or fall on its own merits," they should not be integrated. *Id.* Here, the result should be no different. Yet, even if the Trust Offerings within the fictitious Conduits are partially integrated and grouped by their broader purposes (such as triple-play or security alarm financing), there are still fewer than 35 allegedly unaccredited investors in each such grouping. FoF ¶¶ 609, 615.

Moreover, the separate Trust Offerings meet the remaining factors of the five-factor test. They were made at different times spanning three years (in the case of the fictitious TDM Conduit), and two years (in the case of the fictitious MSF Conduit). FoF ¶¶ 603, 610. They offered certificates issued by different trusts. FoF ¶¶ 607, 613. They offered different securities, which paid different rates of interest at different frequencies and over different periods of time. FoF ¶¶ 608, 614. Consequently, the five-factor test precludes integration.

B. The Offerings Are Exempt From Registration Under Rule 506 of Regulation D

Rule 506 of Regulation D provides a safe harbor for offerings that are deemed to fall within the private offering exemption. 17 C.F.R. § 230.506(a). Under Rule 506, offerings may be made to an unlimited number of "accredited investors", as defined in Rules 501(a)(1)-

(8). 17 C.F.R. § 230.501(e). There must be no more than, or the issuer must reasonably believe that there are no more than, 35 additional *un*accredited investors. 17 C.F.R. § 230.506(b)(2)(i). Any additional *un*accredited investor must have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description." 17 C.F.R. § 230.506(b)(2)(ii).

The Four Funds and the fictitious Conduits (assuming the Division's tenuous integration theory were accepted), are exempt from registration under Rule 506 of Regulation D. As each of Rabinovich, Mayer and Rogers testified, they understood that these offerings were made pursuant to this exemption, and the Offering Documents also noted as much. FoF ¶¶ 113, 139, 627, 652, 671. They also knew that the SEC, the NASD, and McGinn Smith's outside compliance consultant conducted examinations of McGinn Smith during 2004 to 2007, and none raised any issues regarding the number of unaccredited investors in McGinn Smith Securities. FoF ¶¶ 617-22. They were never told that more than 35 unaccredited investors had invested in any McGinn Smith private placement. FoF ¶¶ 628, 653, 672. The only evidence that would suggest more than 35 unaccredited investors subscribed to the Four Funds and the fictitious Conduits is testimony of the Division's summary witness, who prepared the Division's Charts, which were shown to be unreliable and inaccurate. FoF ¶¶ 568-84. Under the circumstances, Section 5 liability as to Rabinovich, Mayer and Rogers is unwarranted (and unprecedented, as discussed later).

C. Rabinovich, Mayer and Rogers Should Not Be Held Liable For Any Purported Violation of Section 5

Assuming *arguendo* that the Division's integration theory was accepted and the Four Funds and the fictitious Conduits were not exempt from registration, Rabinovich, Mayer

and Rogers should not be held liable for any purported violations of Section 5. They took reasonable steps to avoid violating Section 5, any purported violation is either *de minimis*, time-barred, or both, and there is no authority for the proposition that an individual broker should be held liable under these circumstances.

First, Rabinovich, Mayer and Rogers took all reasonable steps to avoid participation in any distribution violative of the registration provisions of Section 5(a) and (c) of the Securities Act. They followed McGinn Smith's written procedures for offering private placements; they had their clients complete subscription agreements and questionnaires to confirm their accredited status; they spoke with and were informed by McGinn Smith's law, compliance and investment banking departments that the McGinn Smith Securities were exempt from registration; and they knew outside counsel had advised McGinn Smith that the McGinn Smith Securities were exempt from registration. FoF ¶¶ 616, 623-31, 648-54, 667-73.

Rabinovich, Mayer and Rogers were not aware, and had no reason to know, that McGinn Smith had accepted subscriptions from more than 35 *un*accredited investors (if, indeed, it did). FoF ¶¶ 628, 653, 672. Subscriptions were sent to the Albany headquarters for review and acceptance by Smith or McGinn, and processed by McGinn Smith employee Patricia Sicluna, who was responsible for tracking the number of unaccredited investors in McGinn Smith Securities. FoF ¶¶ 193, 574, 630. At no time did Smith, McGinn, the General Counsel, the Chief Compliance Officer or anyone else advise Rabinovich, Mayer or Rogers that more than 35 *un*accredited investors had been accepted on any Regulation D offering. FoF ¶¶ 617, 628, 653, 672. Under the circumstances, liability is not appropriate. *See* 17 C.F.R. § 230.508(a)(3) ("A failure to comply with a term, condition or requirement of [Rule 506] will not result in the loss of the exemption . . . if the person relying on the exemption shows: . . . (3) A good faith and

reasonable attempt was made to comply with all applicable terms, conditions and requirements of [Rule 506].").

Moreover, even under the Division's analysis (which we dispute),[11] Rabinovich, Mayer and Rogers presented McGinn Smith Securities to only a few allegedly unaccredited investors, several of whom they understood to be accredited. FoF ¶¶ 632-47 (Rabinovich), 655-66 (Mayer), 674-84 (Rogers); *see also* Demonstrative Exs. C-E. Of these few, nearly all were before September 23, 2008 and are time-barred in any event. For this reason, too, Section 5 liability should not be imposed. *See* 17 C.F.R. § 230.508(a)(2) (exemption not lost where, as here, "failure to comply was insignificant with respect to the offering as a whole").

Finally, dramatically unlike here, the SEC has filed Section 5 charges, and the courts have found Section 5 violations, only (a) where there has been an obvious failure to comply with the registration requirement or with any claimed exemption, *and* (b) where there has been knowing or recklessly deceptive conduct. *See, e.g., SEC v. Cavanagh*, 98 Civ. 1818, 2004 U.S. Dist. LEXIS 13372, at *83 (S.D.N.Y. July 16, 2004) (defendants "merged a shell company with a small and not yet successful operating company, sold stock . . . in an unregistered transaction, took control of virtually the entire market float, created a false impression of interest in the stock . . . issued a false press release, and drove the stock price north of $5 in a 'pump and dump' scheme from which they . . . pocketed millions of dollars."); *SEC v. Gagnon*, 10 Civ. 11891, 2012 U.S. Dist. LEXIS 38818, at *2-14, *19-27 (E.D. Mich. Mar. 22, 2012) (defendant helped orchestrate and promote a massive Ponzi scheme and made outlandish recommendations without basis, soliciting investors on his website, via email and in online chatrooms); *SEC v. mUrgent Corp.*, 11 Civ. 0626, 2012 U.S. Dist. LEXIS 25626, at *2 (C.D.

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[11] For example, Rabinovich did not present FEIN to Richard and Janet Hall. FoF ¶ 635.

Cal. Feb. 28, 2012) (defendants sold unregistered securities, "cold-called investors, used high pressure sales tactics, and made material misrepresentations about . . . mUrgent's allegedly imminent IPO"); *see also SEC v. iShopNoMarkup.com, Inc.*, 04 Civ. 4057, 2007 U.S. Dist. LEXIS 70684, at *28 n.6 (E.D.N.Y. Sept. 24, 2007) (where the Division seeks equitable relief and the Regulation D safe harbor is at issue, the applicable standard is negligence and a Defendant's state of mind is relevant) (citing *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1047 (2d Cir. 1976)). No case authority supports finding a Section 5 violation against Rabinovich, Mayer or Rogers.

III.

28 U.S.C. SECTION 2462 BARS THE CLAIMS ASSERTED IN THE OIP

Beyond the Division's failure to meet its burden on its claims, a controlling federal statute – 28 U.S.C. § 2462 – deprived this tribunal (and any other tribunal) of subject matter jurisdiction to "entertain" all of the claims alleged in the OIP. Section 2462 provides in relevant part:

> [A] proceeding for the enforcement of any civil fine, penalty, or forfeiture . . . shall not be entertained unless commenced within five years from the date when the claim first accrued.

28 U.S.C. § 2462. Every claim alleged in the OIP "*first accrued*" before September 23, 2008 (i.e., more than five years prior to the date the OIP was filed). For that reason, the OIP could not be "*entertained*" here or in any other forum.

In 2013, the Supreme Court held in *Gabelli v. SEC* that a claim "accrues" within the meaning of Section 2462 "when it comes into existence," which occurs "when the plaintiff has a complete and present cause of action." 133 S. Ct. 1216, 1220-21 (2013) (citations omitted). While a claim may accrue on more than a single occasion, the first accrual dictates the date from which the proceeding must be commenced. The OIP asserts two claims as to

Rabinovich, Mayer and Rogers: the Fraud Claim and the Section 5 Claim. The evidence at the hearing conclusively established that both claims "*first accrued*" before September 23, 2008. FoF ¶ 545. The Four Funds, Trust Offerings and alleged "red flags" all first occurred before September 23, 2008, and the claims alleged all "*first accrued*" before that date. In many instances, *all* of the conduct alleged by the Division began *and ended* more than five years prior to the date the OIP was filed.

Simply put, Section 2462 barred this proceeding in its entirety because all claims alleged in the OIP "*first accrued*" before September 23, 2008. For that reason, there was no subject matter jurisdiction to "*entertain*" this case. *See Williams v. Warden*, 713 F.3d 1332, 1337-40 (11th Cir. 2013) ("the great weight of authority" holds that the statutory command – "shall not be entertained" – "is jurisdictional in nature").

IV.

THE DIVISION'S SOLICITATION OF WITNESSES AFTER THE OIP WAS FILED WAS IMPROPER AND MATERIALLY PREJUDICIAL TO RABINOVICH, MAYER AND ROGERS

The Division did not first contact clients of Rabinovich, Mayer and Rogers concerning the allegations in the OIP until *after* filing the OIP on September 23, 2013, some three and a half years after it commenced its action against McGinn Smith, Tim McGinn, Dave Smith, and others in the Northern District of New York (the "SEC Action"). FoF ¶¶ 415, 432, 451, 462, 471, 514. Investors who spoke with the SEC prior to September 23, 2013 were not asked to assist in a case against Rabinovich, Mayer and Rogers. *E.g.*, FoF ¶ 399 (Patel spoke to the SEC in 2010 to "get my money back"). Yet, after the OIP was filed, the Division began dialing for witnesses to find support for their unsupported and conclusory allegations of misrepresentations and omissions.

As the evidence established, in late 2013, Rabinovich, Mayer and Rogers learned from their current clients that the Division was contacting them to be witnesses against them. FoF ¶¶ 686, 692, 699. They had not called their clients to testify. *Id.* Despite calling for months, the Division could only round up seven investors (out of 88 listed in the Division's summary charts), and the husband of an investor to testify against Rabinovich, Mayer and Rogers, FoF ¶ 560, as their clients held high opinions of them as shown by the Division's *Brady* disclosures and testimony proffered at the hearing and in supporting affidavits. FoF ¶¶ 371-97, 421-33, 485-93, 688-89, 694-96, 700-01.

The Division's tactics were materially prejudicial to Rabinovich, Mayer and Rogers' ability to prepare their defense, as well as contrary to the SEC's Rules of Practice, which limit the Division's ability to issue subpoenas (and thus, gather evidence) after the commencement of the proceedings. *See* SEC Rule of Practice 230(g) ("The hearing officer shall order such steps as necessary and appropriate to assure that the issuance of investigatory subpoenas after the institution of proceedings is not for the purpose of obtaining evidence relevant to the proceedings").

V.

THE FAILURE TO BRING THIS PROCEEDING IN FEDERAL COURT WAS MATERIALLY PREJUDICIAL TO RABINOVICH, MAYER AND ROGERS AND DENIED THEM THEIR DUE PROCESS RIGHTS

"The fundamental requirement of due process is the opportunity to be heard 'at a meaningful time and in a meaningful manner.'" *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976). Rabinovich, Mayer and Rogers had no such meaningful opportunity. Despite proceeding against McGinn and Smith in federal court where they would be tried before a jury on similar and overlapping facts, the SEC selectively chose to bring this proceeding administratively seeking a financial death penalty – a permanent bar from the securities industry. This, together with the

inflexible deadlines imposed by the SEC's Rules of Practice that *all* proceedings, regardless of complexity or size, must be instituted, briefed, tried and determined via initial decision within 300 days, was materially prejudicial to Rabinovich, Mayer and Rogers and a denial of due process. *See Mathews*, 424 U.S. at 334 ("[D]ue process is flexible and calls for such procedural protections as the particular situation demands.").

Despite the stakes, no meaningful time (just four months) was provided to review the Division's gargantuan investigative record – consisting of approximately one *terabyte* (1000 gigabytes) of data and 120 cartons of documents housed at the Division's offices. It was literally impossible to review the Division's materials – that the Division produced or made available for review over several months prior to the commencement of the hearing, and in some instances, on the eve of the hearings. *See* FoF ¶ 190 n.4 (noting that the Palen Declaration was provided to Respondents a mere two weeks prior to the hearings and revised a day before the hearing began).

Rabinovich, Mayer and Rogers also had no opportunity to conduct depositions or narrow the scope of this proceeding (*e.g.*, on statute of limitations or subject matter jurisdiction grounds), as Rabinovich, Mayer and Rogers would have had in a federal court case. This is especially prejudicial given the complexity of this case – 26 transactions spanning seven years (2003-2009) with numerous individual Respondents working in four separate locations serving different kinds of customers as part of a brokerage and investment banking firm with some 35 to 50 registered representatives. They were denied the ability to challenge the patent pleading deficiencies in the OIP, as they would have been able to do under the Federal Rules of Civil Procedure. And, they were unable to bar unreliable evidence – including double and triple-hearsay – at the hearing under the Federal Rules of Evidence. Instead, they were subjected to trial by ambush. In light of the Division's four years of investigation and preparation,

Rabinovich, Mayer and Rogers were denied sufficient due process under the circumstances. The only reason the SEC selected an administrative proceeding was to gain an unfair advantage. They did. For all these reasons, it was impermissible and materially prejudicial not to have filed this case in federal court. *See* Answers of Phil Rabinovich, Brian Mayer, and Ryan Rogers, at 48-51.

VI.

NO SANCTIONS SHOULD BE IMPOSED AGAINST RABINOVICH, MAYER OR ROGERS

The evidence established that Rabinovich, Mayer and Rogers did not violate any securities law, rule or regulation, and therefore *no* sanctions are warranted. They acted at all times in their clients' best interests, and the Division proved nothing to support any penalties, let alone its request for third-tier penalties. The Division failed to present evidence justifying a punitive, lifetime bar from the securities industry, the functional "equivalent of capital punishment." *See Paz Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007). Nor has the Division demonstrated that Rabinovich, Mayer and Rogers should forfeit seven years of earned compensation. The sanctions sought by the Division are inappropriate and overreaching, and in any event, time-barred penalties that cannot be imposed under 28 U.S.C. § 2462 following the Supreme Court's decision in *Gabelli*. The Division's claims should be dismissed and its requests for relief should be denied.

A. No Penalty Is Appropriate On This Record

As the evidence showed, Rabinovich, Mayer and Rogers engaged in no conduct that would warrant any penalty against them. No violation of law was proven, certainly not with any *scienter*, or even negligence.

The documentary record as well as the numerous investor witnesses who testified on behalf of Rabinovich, Mayer and Rogers showed three brokers who cared about their clients, who worked with them to further their interests, who dealt with them fairly, honestly, and in good faith, and who, even after learning they had been betrayed by McGinn and Smith's secret theft and diversion of funds, stood by their clients. *See supra*. Not surprisingly, many of Rabinovich, Mayer and Rogers' clients from 2003 through 2009 remain their clients to this very day. FoF ¶¶ 380, 388, 430, 487, 503.

Even witnesses called by the Division testified to their honesty and assistance they provided regarding their investment portfolios. *See, e.g.* FoF ¶¶ 434-51. And, many investors who did not testify submitted affidavits attesting to Rabinovich, Mayer and Rogers' integrity, or so told the Division. FoF ¶¶ 688-89, 694-96, 700-01.

No second or third-tier penalty is appropriate without evidence – non-existent here – that any alleged "act or omission . . . involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." 15 U.S.C. § 78u-2(b). As to Rabinovich, Mayer and Rogers, there was no violation.

Moreover, with respect to the Section 5 Claim, the evidence established that Rabinovich, Mayer and Rogers believed at all times that the McGinn Smith Securities they offered were subject to an exemption from registration, and they took reasonable steps to avoid violating the law. FoF ¶¶ 616, 623-31, 648-54, 667-73. Yet, even if a violation were found, it was *de minimis*, unintentional, and not one for which third-tier (or second-tier) penalties would be appropriate.

Finally, notwithstanding the absence of proof that Rabinovich, Mayer or Rogers violated the federal securities, no penalty may be imposed for alleged conduct that occurred prior

to September 23, 2008. 28 U.S.C. § 2462; *see also SEC v. Jones*, 476 F. Supp. 2d 374, 381 (S.D.N.Y. 2007) (claim for "civil monetary penalties" is "unquestionably a penalty" under section 2462). This would include all offers and sales of the Four Funds, ten of the Trust Offerings, and any conduct described in the testimony of Chapman, Von Glinow, Alberts, and LoScalzo, whose last purchases of a McGinn Smith Security took place long before September 23, 2008.[12] FoF ¶¶ 551-67.

B. The Division's Request for a Punitive Lifetime Bar Against Rabinovich, Mayer and Rogers is Unwarranted and Unsubstantiated

A lifetime bar from the securities industry is an extraordinary remedy. *Steadman v. SEC*, 603 F.2d 1126, 1139 (5th Cir. 1979) ("[T]he greater the sanction the Commission decides to impose, the greater is its burden of justification"), *aff'd*, 450 U.S. 91 (1981). No evidence introduced at this hearing against Rabinovich, Mayer or Rogers supports a lifetime loss of livelihood. And, an analysis of the *Steadman* factors convincingly weighs against such capital punishment.

First, no *scienter* or negligence was shown – indeed, there was no violation. *See supra*. The record reflects no actual intent to defraud, which is highly relevant to the question of what, if any, remedial action should be taken in the public interest or whether penalties should apply at all. The Commission and the courts have emphasized the importance of intent. *In re Steadman Sec. Corp.*, 1977 SEC LEXIS 1388, 30, 46 S.E.C. 896, 909 (June 29, 1977) ("[I]ntent is . . . highly germane to determining the quantum of the remedial action, if any, that due regard

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[12] The Division's spurious contention that this Court should consider the supposed "disciplinary history" of Mayer and Rogers (*see* FoF ¶¶ 17, 28 for the facts) is incorrect. Neither Mayer nor Rogers were subject to the kind of prior conduct properly considered under the statute. *See* 15 U.S.C. § 78u-2(c)(4). The innocuous activities misleadingly referenced by the Division are over ten years old and entirely unrelated to these proceedings. Their records are unblemished.

for the public interest requires us to take"); *Steadman*, 603 F.2d at 1140-41 ("[w]e heartily endorse the Commission's view that . . . the respondent's state of mind is highly relevant in determining the remedy to impose."). With respect to a bar, the Commission "has an obligation to explain why a less drastic remedy would not suffice." *Epstein v. SEC*, 416 F. App'x 142, 147 (3d Cir. 2010) (quoting *Steadman*). Courts have cautioned against imposing such penalties without a factual basis to support reasonable likelihood of future harm. *See SEC v. iShopNoMarkup.com, Inc.*, 04 Civ. 4057, 2012 U.S. Dist. LEXIS 28179, 17-18 (E.D.N.Y. Mar. 3, 2012); *Jones*, 476 F. Supp. 2d at 385. Caution is particularly warranted where the Division's request for relief goes beyond compensation for wronged parties and seeks instead to penalize. *Johnson v. SEC*, 87 F.3d 484, 491 (D.C. Cir. 1996).

Second, the Division's portrayal of Rabinovich, Mayer and Rogers as "continuing threats" to the securities industry is belied by the overwhelming evidence, including the fact that they have operated RMR Wealth Management for the past four years without incident or complaint and offer no proprietary product. FoF ¶¶ 32-40. Rabinovich, Mayer and Rogers were not the wolves of Wall Street operating in a boiler room. To the contrary, Rabinovich, Mayer and Rogers have unblemished records over long careers in the securities industry (FoF ¶¶ 316, 327-28). They have never before been found to have violated any provision of the securities laws. Numerous investors, including those called by the Division, testified as to their honesty, integrity and good business practices.

Third, the Commission's interest in general or specific deterrence – a traditional goal of punishment that is divorced from the public interest – is insufficient to justify a lifetime (or any) bar, especially under these circumstances. *See, e.g.*, *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005). Rabinovich, Mayer and Rogers' lives and reputations already have been

deeply marred by these charges, to say nothing of the financial burdens and family hardship this proceeding has imposed. FoF ¶¶ 691, 698, 702. They were victims of McGinn and Smith's secret theft and deception.

Fourth, the Division's attempt to show "recurrent" conduct – by pointing at commissions earned over seven years – fails. That Rogers, for example, earned about $36,000 per year in commissions (and received no salary) hardly shows recurrent conduct that warrants a sanction. *See* Div. Br. at 40 (Rogers allegedly received $251,443 in commissions over seven years); FoF ¶ 30.[13]

Finally, the Division all but admits that an associational bar is indeed a penalty, and therefore cannot be based on alleged conduct that preceded the limitations period. *See* Div. Br. at 37-38 (distinguishing between the Division's request for alleged "equitable relief" from its request for civil monetary penalties and an associational bar in analyzing the statute of limitations); *see also SEC v. Bartek*, 484 F. App'x 949, 957 (5th Cir. 2012) (SEC's sought-after remedies of a permanent injunction and an officer and director bar were time-barred "penalties," where they did not "address the prevention of future harm in light of the minimal likelihood of similar conduct in the future"); *Johnson*, 87 F.3d at 492 (censure and industry suspension were penalties subject to 28 U.S.C. § 2462). The vast majority of alleged conduct at issue here far precedes September 23, 2008. *See* FoF ¶¶ 545-67.

C. Forfeiture of Commissions Is Not Justified

The Division's request to claw back seven years of compensation (plus prejudgment interest) earned by Rabinovich, Mayer and Rogers from the 26 offerings listed in

[13] The Division also unjustifiably included shared commissions for Mayer and Rabinovich, and $24,000 in commissions for Mayer that were simply tied to the retail production of the entire New York City office. FoF ¶ 21.

the OIP is unjustified by the overwhelming evidence. The Division admits that disgorgement is appropriate only where "those gains were obtained due to fraud or sales that were unlawful for some other reason." *See* Div. Br. at 39. There was no testimony of fraudulent sales.

Moreover, to penalize Rabinovich, Mayer and Rogers, all relatively young men with families to support (FoF ¶ 2, 15, 26), to pay back commissions that they earned, in some cases, more than ten years ago, is far from "non-punitive" as the Division asserts. *See* Div. Br. at 37. The Division's disgorgement request is really a penalty, and is barred by the five-year statute of limitations in Section 2462. *See Riordan v. SEC*, 627 F.3d 1230, 1234 n.1 (D.C. Cir. 2010) (where SEC seeks disgorgement primarily "to fill the Federal Government's coffers," rather than "to make the wronged party whole," it is a forfeiture covered by section 2462); *cf.* 15 U.S.C. § 7243 (codification of Sarbanes-Oxley § 304) (reflecting that compensation clawbacks are forfeitures, not disgorgement).

CONCLUSION

The Division's charges against Rabinovich, Mayer and Rogers were not proven and should be dismissed in their entirety.

New York, New York
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Respectfully submitted,

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