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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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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.

RESPONDENT THOMAS LIVINGSTON'S
POST-HEARING BRIEF

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Respondent Thomas Livingston files this Post-Hearing Brief and respectfully states as follows:

I.
INTRODUCTION

In essence, the Division claims that the Respondents were reckless in not uncovering the fraud perpetrated by McGinn and Smith, who had the active help of their CFOs, general counsel, and outside auditors, among others, to keep it hidden. In other words, the Division claims that all 10 of the Respondents, many of whom barely knew each other and were in separate offices, were coincidentally reckless in not spotting the supposed "red flags." Then again, neither did the other 40-plus brokers who also offered the securities at issue. The SEC and NASD also missed the supposed "red flags" too in their multiple examinations of the firm and the offerings. The simple truth is that Livingston did not miss red flags or lie -- he's a respondent in this case because his sales, while lower than most, put him among the ten highest sellers of what turned out to be, unbeknownst to him, fraudulent securities.

First, a broker does not have a duty of investigation like the Division claims. With regard to the Four Funds, Livingston's duty was to understand that they were non-specific asset programs, that Smith had broad discretion to make the investments, and that the promise contained in those notes was interest rate payments and pay-off at maturity. That is what was described in the PPM, and a broker has a reasonable obligation to understand what that PPM says, which Livingston did.

Based on his experience working with Smith for more than 15 years, Livingston fully believed that Smith had the experience and acumen to manage the Four Funds. Contrary to the Division's baseless claims, Livingston was aware of a substantial portion of the Four Funds' holdings and believed those investments were sound and consistent with the Funds' broad objectives. Indeed, Livingston personally introduced a number of the investments to Smith. For example, as of May 2005, when Livingston had sold all but two of the Four Fund investments at issue, he was aware of approximately 80% of the investments in TAIN and FIIN, the two funds he overwhelmingly sold most.

Second, the Division claims that the PPMs raised a number of "red flags" that should have caused the Respondents to not sell the Four Funds. But, the Division's own expert witness admitted that those supposed "red flags" would have been reviewed by SEC and NASD examiners, who collectively did at least 3 examinations of MS & Co. from 2003 to 2007 and specifically reviewed the Four Funds and at least one Trust. Yet, while the Division claims those "red flags" should have kept the Respondents from selling the Four Funds, trained, experienced SEC and NASD examiners, who had full access to all of MS & Co. and the Four Funds' books and financial records, found no issue. The Division's case is built on the untenable premise that Respondents should have judged the disclosures as "red flags" when the SEC and NASD did not.

Third, as to the very few Trust offerings sold by Livingston, the Division does not provide a basis for liability for selling them. Livingston did more than sufficient due diligence on those offerings. And while it does not seem to matter, the investors who bought those Trusts were aware of the financial troubles of the Four Fund offerings -- Livingston personally told them and they received three letters from Smith. The underlying problems with the Trust offerings -- which were completely different than the Four Funds -- was not with the quality of the investment, but from the fact that McGinn, Smith, and others secretly stole money from them. The Division admits Livingston was not aware of that theft. And, the Division's own expert witness agreed that Livingston could not have discovered the theft absent a forensic review of the Trusts' books, which no one contends he was responsible to do.

Fourth, despite the clear evidence to the contrary, the Division still claims that Livingston lied to two investors -- his two best friends, Dan Ferris and David LaFleche. The Division cannot explain, however, what motivation that Livingston would have for doing so. Livingston did not make his living as a retail broker and his compensation, even under the Division's theory, did not depend on retail sales. He did not stand to profit from the Four Funds or Trusts and certainly was not part of the diversion by Smith and McGinn. And the claim that he lied to his best friends just does not make sense in the overall context of their testimony and the strong character testimony given by others.

However, exemplifying the extent to which the Division will pursue baseless claims, it alleges that Livingston caused Ferris to invest $25,000 in TDM Luxury Cruise without his knowledge or consent.[1] Of course, the evidence actually shows that Ferris and his wife (a) signed a letter asking that $25,000 be transferred to purchase TDM Luxury Cruise; (b) signed a Subscription Agreement to purchase TDM Luxury Cruise; (c) received a confirmation of their purchase of TDM Luxury Cruise; and (d) receive monthly statements showing their TDM Luxury Cruise investment. It is simply absurd to claim that Ferris did not know about or consent to the investment. Nevertheless, the Division persists in this frivolous claim.

The Division does not actually indicate any alleged lies to LaFleche. Instead, it claims that Livingston did not follow LaFleche's instructions to put his money in something "safe and secure." Notwithstanding that LaFleche never gave those instructions, the evidence shows that LaFleche's investment objectives were clear -- he wanted to invest in what Ferris invested in. Moreover, while he conveniently claims to either not to have read or received the offering documents, he does recall receiving and signing documents, which of course had to be the

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[1] The Division originally claimed that Ferris had instructed Livingston to put the $25,000 into a money market account. *See* Div. Second Suppl. Disclosure at 7. Ferris testified that claim was simple false. Tr. 63:10-17.

offering documents. Those clearly lay out the substantial risks involved in the investments that LaFleche made. And while he secretly may not have believed he would lose his money based on Ferris' experience, he admitted he knew he could. The Division also claims Livingston changed one of LaFleche's investor questionnaires to make him an accredited investor, which Livingston absolutely did not do. But, regardless of who made the change, it would have made no sense for Livingston to do so because LaFleche did not qualify as an accredited investor even under the revised asset range.

Fifth, perhaps most remarkable is the Division's efforts to ensnarl Livingston into the linchpin of their case -- the so-called Redemption Policy. The Division has proclaim this policy as the "hallmark" of the fraud. Trouble is, Livingston was not aware of it. The Division's own expert spent the majority of his report on this issue, but ultimately had to admit that this issue did not relate to Livingston, because there was simply no evidence that Livingston was aware of such a policy during the relevant time. Nevertheless, in a desperate attempt to make its case, the Division introduced an e-mail where an investor was seeking to get out of a Fund investment <u>18 months before the note matured</u>. The so-called Redemption Policy had nothing to do with early withdrawals -- which the PPMs make clear were not generally allowed, but a supposed refusal to redeem notes that had matured without a replacement investor. Simply put, the one piece of "evidence" the Division relies upon is no evidence at all.

Throughout this case, the Division had ignored that McGinn and Smith masterminded a sophisticated and pervasive fraud. They exploited the 20-plus year successful track record and local prominence of their firm to perpetuate their fraud. Smith and McGinn colluded with others within the firm -- including its CFOs, senior accounting and legal officers --and its auditors to further their fraud and which made it virtually impossible for their fraud to be detected. They used "Ponzi-like" payments, false accounting entries, fraudulent tax returns, and created false documents to hide their scheme. When liquidity issues with the Four Funds arose, Smith was able to hide the full nature of the issues because the problems were completely consistent with the general economic downturn, which the Division pretends did not exist.

The fact is the McGinn and Smith stole from their investors. Livingston is not to blame for what happened. He did not lie to anyone or commit fraud. He had a reasonable basis for recommending the securities at issue. While it may be cliché, the Division's case is simply 20/20 hindsight. Neither the law nor facts support liability against Livingston.

II.
ARGUMENTS & AUTHORITIES

Livingston relies on and incorporates herein his Proposed Findings of Fact, filed herewith, as his statement of facts.

A. The Division's Claims are Time-Barred

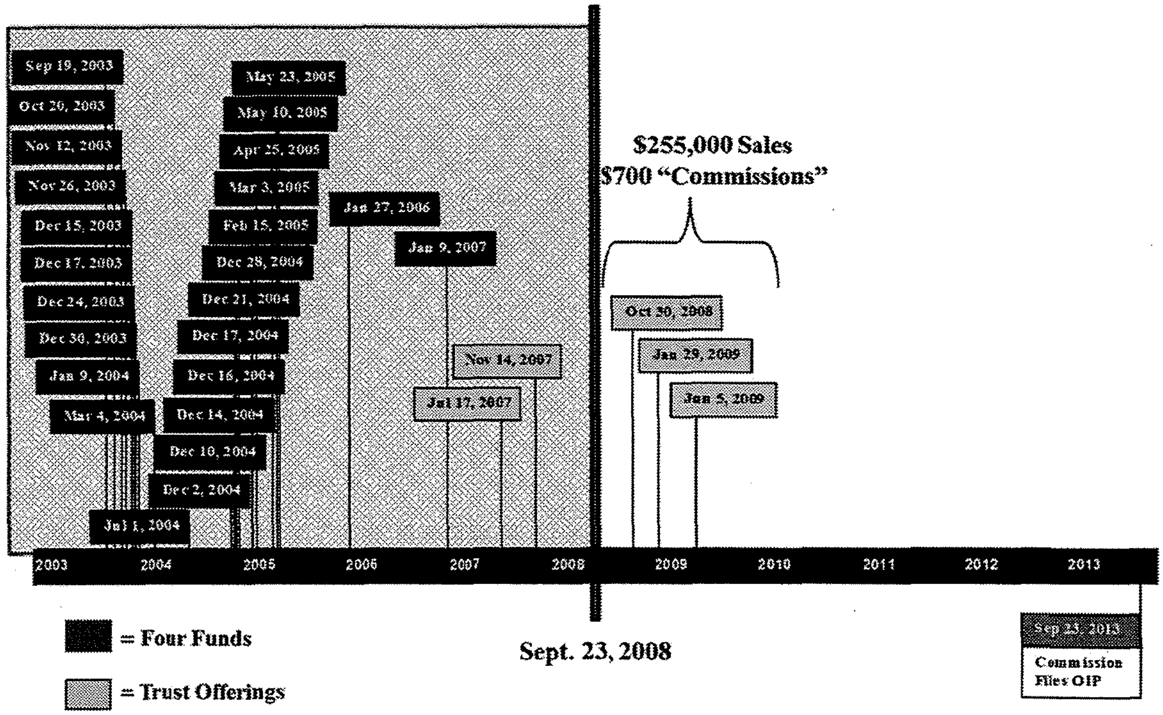
1. The Division Seeks to Punish Livingston Based on Claims that Are Time-Barred.

The Division may only seek civil penalties for claims that "first accrued" within five years of the date that it initiated this proceeding. 28 U.S.C. § 2462; *Gabelli v. SEC*, 586 U.S. 133, 133 S.Ct. 1216 (2013). The Supreme Court recently reiterated this limitation should be interpreted narrowly. *Id.* While paying lip service to this mandate, the Division continues to ignore it by suggesting penalties are appropriate based on allegations of pre-2008 misconduct.

The Division initiated this action on September 23, 2013. Thus, under Section 2462, it may not pursue penalties for claims that "first accrued" prior to September 23, 2008. Nevertheless, the Division urges the Court to assess penalties based on Livingston's sales of interests in the Four Funds, *see, e.g.,* Post-Hearing Brief of the Division of Enforcement ("Brief") p. 3 ("Selling Respondents are directly liable for Section 5 violations because they offered and sold Four Funds notes and Conduit Entity Trust Offerings…"). The Division's own evidence establishes these sales took place between September 19, 2003 -- more than a decade before this OIP was issued -- and January 9, 2007 -- more than 6 1/2 years before.

Similarly, any claims based on Livingston's sales of the Trust Offerings first came into existence when he made his first sale on July 17, 2007 -- over 6 years before this proceeding. *See Gabelli*, 133 S. Ct. at 1220-21 (finding a claim "accrues" within the meaning of 2462 "when it comes into existence" -- that is, "when the plaintiff has a complete and present cause of action."). While literally a handful of sales in the Trust Offerings occurred between October of 2008 and June 5, 2009, it is illogical to contend that these impact the accrual date of claims based on Livingston's Trust Offering sales because the claims could not "come into existence" more than once and thus cannot be based on the subsequent sales. *See, e.g., SEC v. Jones*, 2006 U.S. Dist. LEXIS 22800 at *12 (S.D.N.Y. April 25, 2006) (rejecting the SEC's attempts to label each alleged violation -- collections of allegedly excessive fees -- as a new breach by the defendants).

The following timeline (using Palen's disputed list of sales and commissions) clearly shows that the Division's claims first accrued more than five years before the OIP:



Ultimately, the crux of the Division's argument is that Livingston should be subject to penalties based on purportedly "failing to investigate and resolve red flags." Br. p. 17. But, nearly every event the Division claims should have prompted further investigation is specific to investigation in connection with the sale of the Four Funds, not the Trust Offerings -- meaning sales that are prior to the limitations period and are not the subject of this proceeding. More specifically, the alleged "red flags" are as follows:

- The ***Four Funds*** Had a Totally Different Investment Mandate Than the Pre-2003 Trust Offerings
- Smith Had Never Served as a Fund Manager for Offerings Similar to the ***Four Funds***
- Smith Controlled the Issuer, Placement Agent, Owner and Sole Managing Member, Issuer, Trustee and Servicing Agent for the ***Four Funds*** Offerings
- The ***Four Funds*** PPMs Disclosed that the LLCs Could Acquire Investments from MS & Co. Affiliates
- The ***Four Funds'*** PPMs Limited Sales to Accredited Investors Only

- Smith Was Secretive Regarding How He Invested ***Four Funds*** Proceeds

Br. pp. 18 - 25 (emphasis added).

Accordingly, these discussions are irrelevant and cannot provide a basis for penalizing Livingston.

2. The Division's Request for Disgorgement, Industry Bar, and Monetary Penalty Fall Within Section 2462.

Although the Court previously found he statute of limitations did not bar this proceeding in its entirety, even the Division admits that limitations apply "to particular sanctions." Br. p. 37, n. 5 (citing *Matter of Raymond J. Lucia Cos., Inc., et al.*, No. 3-15006, 2013 WL 6384274, at *53 (Dec. 6, 2013)). The Division also acknowledges non-punitive relief is not subject to the five-year statute of limitations, but incorrectly concludes that means disgorgement is not either. Br. pp. 37-38. Disgorgement is subject to limitations where, as here, it constitutes a "penalty" for purposes of Section 2462.

As explained in the landmark case, *Johnson v. SEC*, "a 'penalty,' as the term is used by Section 2462, is a form of punishment imposed by the government for unlawful or proscribed conduct, which goes beyond remedying the damage caused to the harmed parties by the defendant's action." 87 F.3d 484, 488 (D.C. Cir. 1996); *see also Gabelli*, 586 U.S. at 133 (penalties "go beyond compensation [and] are intended to punish, and label defendants as wrongdoers"). Determining whether proposed remedies are penalties subject to Section 2462 requires a "fact-intensive inquiry." *See SEC v. Alexander*, 248 F.R.D. 108, 115–16 (E.D.N.Y. 2007) (citing *Johnson*, 87 F.3d at 488). "[W]here a legal action is essentially private in nature, seeking only compensation for the damages suffered, it is not an action for a penalty." *Johnson*, 87 F.3d at 488. But where a sanction has "collateral consequences" beyond the immediate sanction, and is based mostly upon past conduct rather than a current "risk [that the defendant] poses to the public," the sanction is a "penalty" subject to section 2462. *Id.* at 488-490 (finding censure and six-month suspension constituted penalties because the sanctions carried "longer-lasting repercussions on [the manager's] ability to pursue her vocation," and "were not based on any general finding of [the defendant's unfitness as a supervisor, nor any showing of risk she posed to the public, but rather on [her past acts].").

Under the *Johnson* test, it is well-established that the imposition of civil monetary penalties or permanent industry bars are both considered a penalty, which the Division appears to concede. *See, e.g., Jones*, 476 F. Supp. 2d at 381; *Johnson*, 87 F.3d at 489; *Microtune*, 783 F. Supp. 2d at 885-886; *Bartek*, 484 Fed. Appx. at 957; *DiBella*, 409 F. Supp.2d at 128 n.3; *Proffitt v. FDIC,* 200 F.3d 855, 860-62 (D.C. Cir. 2000). However, courts have also found that equitable relief -- such as disgorgement -- may constitute a penalty subject to Section 2462. *See, e.g., Riordan v. SEC*, 627 F.3d 1230, 1234 n. 1 (D.C. Cir. 2010) (noting "disgorgement is a kind of forfeiture covered by § 2462, at least where the sanctioned party is disgorging profits not to make the wronged party whole, but to fill the Federal Government's coffers."); *In re Arnold*, Release No. ID-108, 1997 WL 126714, at *15 (March 19, 1997) (finding, under the circumstances, disgorgement and cease and desist would constitute penalties subject to Section 2462); *see also In re Telsey*, 144 B.R. 563, 1992 Bankr. LEXIS 1411 (Bankr. S.D. Fla. 1992) (accepting the Commission's argument that a disgorgement obligation constitutes "a fine, penalty, or forfeiture" under another federal statute). Further, while disgorgement is a penalty/forfeiture itself, it is especially true here because Livingston did not actually receive any commissions from the offerings -- rather he received a set draw.[2] Without proof of actual receipt

[2] Beyond a Division employee's testimony (Keri Palen) about what she believes some unspecified documents (which were not offered into evidence) showed, the Division offered no evidence that Livingston was actually paid any commissions for retail sales beyond a single payment in January 2008, which Livingston was unaware that he received. Palen theorized that Livingston in essence "received" retail commissions because she believed that the

of the commissions that the Division alleges, disgorgement is not appropriate. *See SEC v. Seghers*, 2010 WL 5115674, at *1 (5th Cir. Dec. 13, 2010) ("the party seeking disgorgement must distinguish between gains that were legally and illegally obtained" and affirming district court's order denying disgorgement due to SEC's failure to distinguish gains). Moreover, Livingston has already agreed to pay back $120,000 in compensation that he received in settlement with the receiver -- ordering further disgorgement on top of that amount would further be a penalty.

3. Conduct Beyond the Limitations Period May Only Be Considered Under Limited Circumstances, which Are Not Present

The Division takes the untenable position that even if the five-year statute of limitations applies (thereby precluding a liability determination as to the claims relating to the overwhelming majority of the transactions discussed in its Brief), the Court should nonetheless consider the vast majority of untimely sales (i) to establish motive, intent, or knowledge, and (ii) in determining the appropriate sanction if violations are proven.

First off, such contentions fly in the face of the purpose of the statute of limitations and would render Section 2462 meaningless. In reality, the Division is asking the Court to punish Livingston for alleged misconduct that occurred more than five years before this proceeding was initiated. As the Supreme Court recently reiterated in emphasizing the importance of time limits on penalty actions, "it 'would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time.'" *Gabelli*, 133 S.Ct. at 1218 (quoting *Adams v. Woods*, 2 Cranch 336, 342, 2 L.Ed. 297). While the statute of limitations does not act as an evidentiary bar, *see In the Matter of Joseph J. Barbato*, No. 3-8575, 1999 WL 58922, at *13 &

commission revenue (institutional and retail) attributable to Livingston did not exceed his salary over the relevant time period, but she did not provide the Court with an analysis of this. Tr. 550:17-23, 553:6-17, 561:18 - 563:3; 576:14-24. There's no evidence that Livingston received any information showing he was being paid for retail sales. Tr. 6034:23 - 6035:9, 6038:10-13.

n.26 (SEC Feb. 10, 1999), it does not provide an unlimited supply of potential untimely violations from which to craft an onerous sanction. *Cf. Turner v. Upton County, Texas*, 967 F.2d 181, 185 (5th Cir. 1992) (holding, in a case brought under 42 U.S.C. § 1983, that a plaintiff cannot recover for damages arising from conduct that was time barred by the statute of limitations). Such a system would make a mockery of the purpose of the statute of limitations.

In addition, the Division overstates the breadth of the relevant authorities in asserting its position. As its authorities establish, "Section 2462 precludes our consideration of [respondent's] conduct occurring before [the five-year period] in determining whether to impose a bar or civil penalty." *Trautman*, 2009 WL 6761741, at *20. Alleged misconduct that occurred prior to the five-year period may only be considered for the limited purpose of determining whether the respondent had the requisite motive, intent, or knowledge in carrying out timely violations. *Id.*;[3] *see also In the Matter of Lucia*, 2013 WL 6384274, at *53 (conduct that occurred prior to limitations period could not be considered in the proceeding); *In the Matter of Bandimere*, No. ID-507, 2013 WL 5553898, *75 (Oct. 8, 2013) (material misrepresentations or omissions could not be deemed violations if based on any offers, sales, or purchases of securities prior to the limitations period).

The limited authorities permitting such consideration rely on a single case: *In the Matter Terry T. Steen*, Release No. 40055, 53 SEC 618, 1998 WL 278994 (June 2, 1998). In *Steen*, the court was permitted to consider events that occurred prior to the five-year limitations period (*i.e.*, prior to 1991), "where relevant, to establish Respondent's motive, intent, or knowledge in the commission of the 1991 and 1992 violations." 1998 WL 278994, at *4. Unlike this case, the

[3] In *Trautman*, the court considered pre-limitations conduct, but only because the sanctions were not subject to Section 2462 under the circumstances in that case. 2009 WL 6761741, at *20. *Trautman* was also decided prior to the landmark *Gabelli* decision.

prior conduct was indeed relevant in determining whether the respondent had sufficient knowledge to establish a violation. The respondent was charged with selling unregistered securities, namely interest in Star-Tech, to affiliates of the issuer without satisfying the conditions of Rule 144. The respondent argued that he met his duty of inquiry with respect to the subject transactions that occurred during the limitations period. The pre-limitations period transactions that the respondent brokered were sales of Start-Tech stock by Star-Tech affiliates: the wife of Start-Tech's president and CEO (who was herself Star-Tech's secretary and treasurer) and a Star-Tech director. Thus, the sales were relevant to the level of the respondent's awareness about the propriety of the subsequent transactions, to the extent that the subsequent sales were made by an entity that was owned and controlled by the affiliated individuals that took part in the initial transactions, and facilitated by the same individuals. *Id.* at *4.

The *Steen* court ultimately concluded a six-month suspension was appropriate -- not a permanent bar. Furthermore, it indicated consideration of the pre-limitations conduct was in fact irrelevant: "[e]ven if we were barred from considering the pre-September 1990 transactions for purposes of determining what sanction is in the public interest, however, [respondents'] wrongful conduct in 1991 and 1992 supports imposition of a six-month suspension." *Id.* at *5.

Similarly, the Division's second contention is immaterial to the allegations asserted against Livingston as there are no "proven" violations. The Division's authority finds misconduct that occurred outside of the statute of limitations may only be "considered in determining the appropriate sanction if violations are *proven*." Brief p. 38 (citing *Matter of Warwick Capital Mgmt, Inc.*, No. 3-12357, 2007 WL 505772 (Feb. 15, 2007)) (emphasis added); *see also In re Prime Capital Services, Inc. et al.*, File No. 3-13532, Release No. 398, at *3 (June 25, 2010); *In re Robert W. Armstrong, IIII*, Release No. 248 (S.E.C. Release No.), 82 S.E.C.

Docket 2251, Release No. ID - 248, 2004 WL 737067 (April 6, 2004); *In re David A. Finnerty, et al*, Release No. 381 (S.E.C. Release No.), 96 S.E.C. Docket 1098, Release No. ID - 381, 2009 WL 2013415 (July 13, 2008); *In the Matter of Trautman*, Securities Rel. No. 9088A, 2009 WL 6761741 (Dec. 15, 2009). The Division's "wealth of evidence concerning events and actions that occurred before September 2008" does not include any evidence of proven violations that Livingston was charged with in other proceedings. Brief p. 38; *see In re Next Financial Group, Inc.*, No. 349, 2008 WL 2444775, at *46 (June 18, 2008) (rejecting Division's claim that prior misconduct evidenced by letters of caution from the NASD and deficiencies in SEC examinations that were referred to the Division for possible enforcement action could be considered in assessing sanctions).

In addition, the only case that the Division relies upon, *Warwick*, predates the seminal *Gabelli* decision. And, the facts of that case are easily distinguished from *Warwick,* which involved an investment advisor founded by the respondent, who was the owner. Unlike Livingston, the respondent in *Warwick* made "all the investment decisions, while [his wife] perform[ed] administrative work; they [were] the only employees." 2007 WL 505772, at *2. The respondent inflated Warwick's assets under management in written reports to the Commission, supplied inflated performance data in writing to the database services, and made excuses for his inability to produce records that would support the inflated numbers, instead creating after-the-fact documents concerning the inflated numbers. *Id.* at *3. In finding the respondent violated several provisions of the Advisers Act, the court considered the common thread of misrepresentations, including those prior to the five-year cut off.

It is a fundamental principle that allegations regarding prior bad acts, including a respondent's prior disciplinary action, must not be used to demonstrate the respondent's propensity to violate regulations. *See, e.g., In re H.J. Meyers & Co., Inc.*, No. 211 (Aug. 9, 2002) (citing Fed R. Evid. 404(b)). This is because a respondent should not be convicted because of his character, nor because of past misdeeds, but only because of his guilt on the particular occasions that serve the basis of the violations of which he is charged. *Id.* n. 49. As the Supreme Court has stated emphatically, such evidence is excluded not because it is irrelevant, but because exclusion "tends to prevent confusion of issues, unfair surprise and undue prejudice." *Michelson v. U.S.*, 335 U.S. 469, 475–476 (1948). Permitting consideration of Livingston's alleged pre-2008 conduct -- conduct he was not timely charged for and has not been proven to be wrongful -- would inarguably confuse the issues and unfairly prejudice Livingston.

B. Livingston Did Not Commit Fraud

Liability under section 10(b) and Rule 10b-5 requires proof that Livingston: (1) made a material misrepresentation or employed a fraudulent scheme or device; (2) indicating an intent to deceive or defraud - in other words, with scienter; (3) in connection with the purchase or sale of a security. *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir.1999); *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1467 (2d Cir.1996). The standard for establishing a violation of Section 17(a) is essentially the same as for establishing a violation of § 10(b) and Rule 10b–5, and to prove a violation of it requires the same elements. *See U.S. SEC v. Universal Exp., Inc.*, 475 F.Supp.2d 412, 422 (S.D.N.Y. 2007) (citing *Monarch*, 192 F.3d at 308). The Division has not demonstrated that Livingston made any material misrepresentations or omissions, nor that the facts are anywhere close to establishing he had the requisite intent.

1. Livingston Did Not Make Material Misrepresentations or Omissions

In the present case, there are no representations or omissions that Livingston made or failed to make, let alone any that are material. Information is material "if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest]."

Basic v. Levinson, 485 U.S. 224, 231 (1988). In the case of an omission, to fulfill the materiality requirement there must be a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.*

The Division identifies two categories of alleged misrepresentations. First, it claims generally that Respondents represented to "investors that Smith and McGinn had reliable track records:" Br. p. 26. There is simply no evidence that Livingston made any representations about Smith and McGinn's track record. Second, the Division generally alleges that Respondents represented to investors that their principal would be safe. *Id.* Again, there is no evidence that Livingston ever made this claim and, in fact, the evidence is that (a) Livingston verbally told all his investors of the risk (*see, e.g.,* Tr. 5231:9 - 5232:17, 43:15-18), and (b) provided them with the Offering Documents, which state numerous times that investors could lose their entire investment. *See, e.g.,* Tr. 5229:20-24. The fact that investors received disclosures about the significant risks of these investments destroys any materiality. *See, e.g.*, *Phillips v. LCI Int'l*, 190 F.3d 609, 617 (4th Cir. 1999) ("'[E]ven lies are not actionable' when an investor possesses information sufficient to call the misrepresentation into question); *One-O-One Enters., Inc. v. Caruso*, 848 F.2d 1283, 1286 (D.C. Cir. 1988) (Ginsburg, J.) (oral representations "immaterial" when they conflicted with written agreement containing integration clause).

As far as omissions, the Division contends that Livingston failed to "disclose the risk factors associated with these investments." Br. p. 26. But, again, the risk factors were specifically identified within the PPMs, which were available, and provided, to the investors Livingston sold interests to. As explained above, the failure to verbally repeat such information would not have significantly altered the total mix of available information. Likewise, allegations that Livingston failed to disclose to investors adverse information that he knew of or that was reasonably ascertainable are unsubstantiated.

It is telling that the Division can only identify two "examples" of Livingston's misrepresentations and omissions, both of which are refuted by the evidence. First, it claims Livingston never mentioned any risks concerning the notes he recommended to LaFleche (Br. p. 28). However, LaFleche does not dispute being given PPMs -- which fully disclosed the associated risks -- or signing Subscription Agreements for the investments that he made (Tr. 113:5-20, 117:10-12, 127:16-20). And, LaFleche acknowledged Livingston never told him that he could not lose his money. Tr. 107:19-21, 135:2-4. Even the Division's own expert acknowledged that investors were told they could lose their entire investment in the Four Funds. Tr. Tr. 839:12-18. Similarly, allegations that Livingston never told Ferris about any of the problems at MS & Co. about which he was aware must fail. *See* Br. P. 28. There is no evidence Livingston had knowledge of the "problems" referenced. Indeed, according to the Division's own expert, absent a forensic review, Livingston would not have been able to know about the diversion of money raised in the Trust Offerings. Tr. 1244:14-18, 1244:25 - 1245:4, 1250:7-18. Furthermore, both LaFleche and Ferris were fully aware of the liquidity problems experienced by the Four Funds prior to investing in the Trusts. Tr. 5251:23 - 5252:12. Ferris even admitted that Livingston told him that his TAIN and FIIN investments were in trouble. Tr. 43:15-18.

2. *The Division Cannot Establish Scienter Through Its Watered-Down Version of Recklessness*

"The element of scienter requires a plaintiff to show that the defendant acted with intent to deceive, manipulate, or defraud, or at least knowing misconduct." *SEC v. Milan Capital Group, Inc.*, 2000 WL 1682761, at *4 (Nov. 9, 2000) (internal quotation omitted); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). While scienter may be established through a showing of reckless disregard for the truth, the type of extreme recklessness necessary to satisfy the scienter requirement is narrowly defined as follows:

> [H]ighly unreasonable (conduct), involving not merely simple, ***or even inexcusable negligence***, but an extreme departure from the standards of ordinary care, ...which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

Infinity Group, 212 F.3d 180, at 192 (2000) (citing *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)) (emphasis added).

In other words, it is "the kind of recklessness that is equivalent to wilful fraud." *Sundstrand*, 553 F.2d at 1045 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 868 (2d Cir. 1968) (Friendly, J. concurring) (*en banc*). It "should be viewed as the functional equivalent of intent," and requires that "the danger of misleading buyers must be actually known or so obvious that any reasonable man would be legally bound as knowing." *Id.*; *see also In re Time Warner, Inc. Sec. Litig.*, 9 F.3d 259, 268-69 (2d Cir. 1993). "Extreme recklessness" is neither ordinary negligence nor "merely a heightened form of ordinary negligence." *Steadman*, 967 F.2d at 641.

The Division failed to show Livingston acted with scienter, either based on actual knowledge or extreme recklessness. The Division puts great weight on the Four Funds' investment in alseT to prove scienter. However, those loans were not prohibited under the Four Funds' PPMs[4] and legal counsel was consulted about the issue. Moreover, Livingston only sold one investment in a fund that had loaned money to alseT, but when he did, he had a reasonable

[4] The Division put great weight on the investments in "affiliates." However, Palen did no analysis of whether the entitles were affiliated with MS & Co., but rather was told who to include by Division lawyers. Tr. 523:5 - 524:7. The Division admitted that it use affiliates, not as defined under the Securities Act, but to mean some form of shared ownership. Tr. 5348:2-3. Indeed, alseT would not qualify as an affiliate of MS & Co. under the Securities Act. *See* 17 CFR 240.12b-2. But, the evidence shows the term was used more loosely. Palen included companies as affiliates if there was any connection, including one owned by former MS & Co. employees (Atlantis), where one of the principals serves on the board (Century Same Day Surgery), or where MS & Co. was the placement agent (State Street Hospital). Tr. 2428:18 - 2431:12.

belief that alseT would quickly replay all of its obligations. alseT had nothing to do with the few Trust Offerings that Livingston sold. In sum, alseT was a legitimate company with a viable business model -- it just fell victim to timing with the 2008 financial crisis, as many other businesses did.

Livingston did not act recklessly -- let alone act with the extreme recklessness required to establish scienter. This is not a case where Livingston lacked any reasonable basis for recommending the offerings. At all times relevant to this proceeding, the firm maintained an outstanding reputation as a premier independent investment banking house that had successfully financed several companies in the Capital Region, including the Saratoga Civic Center, local hospitals, and a variety of other businesses. McGinn and Smith owned and managed the firm since its inception in 1980 and had a proven track record. Livingston worked with and trusted these men for many years -- men who, in his experience, had been legitimately successful.

Nor is this a case where Livingston ignored obvious red flags that would have alerted him to any illegality or fraud. Livingston relied on the firm's accounting department, CFO, and general counsel, without any indication that they were in collusion with the perpetrators. *See* TL Ex. 1, 2, 60, Tr. 2420:6 - 2423:10. With these key players' participation, McGinn and Smith were able to systematically conceal their fraud not only from numerous firm employees and hundreds of investors, but also from trained examiners of both the SEC and the NASD. Red flags are always more obvious in hindsight, but at the time, Livingston (like everyone else) had no reason not to trust Smith and McGinn, and had no reason to believe he was provided any misinformation.

a. Livingston Had a Reasonable Basis for the Recommendations, Thus Complied with His Due Diligence Obligations

A broker-dealer only has a "duty to investigate" such that it has an "adequate and reasonable basis" for statements it makes to the public regarding a security. *Hanly v. SEC*, 415 F.2d 589, 595-96 (2d Cir. 1969); *Hiller v. SEC*, 429 F.2d 856, 857 (2d Cir. 1970) (characterizing standard as "duty to avoid use of unconfirmed rumors and reports as a basis for recommending stock to purchasers"). If a reasonable basis exists, a broker-dealer does not have a duty to verify the actual truth of its assertions. *University Hill Found. v. Goldman, Sachs & Co.*, 422 F. Supp. 879, 898 (S.D.N.Y. 1976) ("[E]xcept in unusual circumstances the obligation to investigate does not impose a duty of first hand verification."); *Levine v. SEC*, 436 F.2d 88, 90) ("[Absent] actual knowledge or warning signals, a broker-dealer should not be under a duty to retain his own auditor to re-examine the books of every company."); *In The Matter Of Edgerton, Wykoff & Company And O. Victor Wykoff*, 36 S.E.C. 583, 1955 WL 43201 (S.E.C. 1955) (finding no liability for securities fraud because the brokers had no reason to doubt the validity of the information supplied).

There are no stringent rules for how a broker-dealer meets his duty of reasonable investigation, however several factors have been deemed relevant. *University Hill Found*, 422 F. Supp. at 898. The amount of facts and depth of analysis required increases as does the number of shares being sold by the broker, the number of customers approached, and the dollar volume involved. *Id.* Other factors include the "role of the broker-dealer in the transaction, his knowledge of and relation to the issuer, and the size and stability of the issuing company." *Id.*; *see also Hanly*, 415 F.2d 589; *Quincy Co-op Bank v. A.G. Edwards & Sons, Inc.*, 655 F. Supp. 78 (D. Mass. 1986). "Securities issued by smaller companies of recent origin obviously require more thorough investigation." Br. p. 10 (quoting *Pinkerton*, 1996 WL 602648, at *5, and *Hanley*, 415 F.2d at 597).

Applying these factors, the Commission dismissed proceedings against two brokers charged with violations of Sections 17(a) and 10(b), upon finding the brokers conducted a sufficient investigation of the security recommended. *Wykoff*, 1955 WL 43201. Specifically, the Commission highlighted that the broker's optimistic predictions were reasonable based on the recent successes of similar companies in the industry. *Id.* at 591 (noting that the brokers' activities took place "in a period of great public optimism with regard to the television companies and their stocks, certain of which had had spectacular market rises."). Additionally, the Commission emphasized the brokers' constant communication with the company's management and the good reputation and personal wealth of the company's president in finding that brokers' belief in the company's stock was reasonable. *Id.*

The PPMs were not questionable on their face and did not contain information inconsistent with what Livingston understood otherwise. *Cf. SEC v. Milan Capital Group, Inc.*, No., 00 CIV. 108, 2000 WL 1682761, at *5 (finding that a duty to investigate is greater when the promotional materials are questionable or potentially misleading); *SEC v. Randy*, 38 F. Supp. 2d 657, 670 (N.D. Ill. 1999) (finding that a minimal investigation would have revealed that the issuer was not licensed as a bank, had no assets, and was not located where it claimed it was located); *Everest Secs., Inc. v. SEC*, 116 F.3d 1235, 1239 (8th Cir. 1997) (finding that a cursory investigation would have revealed facts inconsistent with the PPM).

As set forth in his proposed Findings of Fact, Livingston did conduct due diligence of the Four Funds and the Trust Offerings. Completely contrary to what the Division blindly claims, Livingston was aware of a substantial amount of the Four Funds' investments and, in fact, introduced a number of companies that the Four Funds invested in. He, unlike most, also constantly observed Smith's oversight and management of the funds, including observing due diligence Smith conducted. Livingston also conducted extensive due diligence of the Trust Offerings that he sold and the SEC has yet to identify what else he was supposed to do.

The Division's expert confusingly asserts that based on a 2010 Notice to Members, the brokers have the same due diligence obligations as a broker-dealer. Tr. 652:3-7. Of course, all the conduct here occurred before 2010. Further, NTM 10-22 talks about <u>concomitant</u> duties of member and associated person (registered representative) -- meaning "happening at the same time as something else" or "accompanying especially in a subordinate way." The Division's expert also claimed that NASD rules at the time required brokers to investigate private placements, but the rules cited do not use the term "investigate." Tr. 649-650. Before 2010, neither FINRA, the NASD, nor the SEC had issued any guidance on what due diligence a broker-dealer ought to do specifically in connection with Reg D offering. Tr. 1225:14-25. The Division seeks to impose a determination of product suitability upon the respondents, but that duty is exclusively on the broker-dealer. The Division does not contend that Livingston did not adhere to his reasonable basis and customer suitability determinations.

To the extent that the Division seeks to impose liability based on any misstatements within the PPMs, its claims must also fail. Livingston cannot be liable for any alleged misstatements within the PPMs, or those which he repeated, because Livingston did not "make" the statements. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). Moreover, Livingston's duty to investigate does not provide grounds for holding him liable based on representations that the statements in the PPMs were truthful and complete. *SEC v. Tambone*, 597 F.3d 436, 447 (2010) (finding such a theory would "impose primary liability under Rule 10b-5(b) on these securities professionals whenever they fail to disclose material information not included in a prospectus, regardless of who prepared the prospectus," which would be "tantamount to imposing a free-standing and unconditional duty to disclose" and that "imposition of such a duty flies in the teeth of Supreme Court precedent."); *see also In re Fannie Mae 2008 Secs. Litig.*, 891 F.Supp.2d 458, 485 (S.D.N.Y. 2012).

The circumstances in which courts have found breach tend to involve almost a complete failure on the part of the broker to conduct an investigation -- circumstances that are simply not present here. *See, e.g., Milan Capital Group*, 2000 WL 1682761 ("broker's only attempt to investigate was rebuffed when he was temporarily denied access to the company's books"); *Infinity Group Co.*, 993 F. Supp. at 329–30 (broker failed to request any financial statements, opinions of counsel, or third party analysis).

b. The Purported Red Flags Are Insufficient to Establish Liability

As previously discussed, the purported "red flags" only relate to investigations the Division claims Livingston should have done in connection with sales of the Four Funds, thus are time-barred. Even putting that aside, there is no evidence these events were sufficient to "raise enough questions about the legitimacy of an investment to make a person's failure to investigate before recommending that investment reckless." *Milan*, 2000 WL 1682761, at *5. Extreme recklessness may only be found if the respondent encountered "red flags" or "suspicious events creating reasons for doubt" that should have alerted him to the improper conduct of the primary violator, or if there was a danger so obvious that the respondent must have been aware of it. *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (internal citations omitted). The facts "must be viewed in their contemporaneous configuration rather than in the blazing light of hindsight." *Sundstrand*, 553 F.2d at n.19.

The Division indicates there are "ten categories of red flags" in the present case, but fails to provide a single authority establishing these particular categories (even assuming they are present), are sufficient to impose liability. Instead, the handful of cases cited indicate the

Division's alleged categories are not the type of "red flags" that have been found sufficient to establish liability for failure to investigate. Indicia of fraud found sufficient to impose liability identified in the Division's authorities include the following: memoranda regarding financial difficulties, rapid turnover of management, errors in financial statements, prior misconduct, and obviously evasive and suspicious statements by principal. Brief p. 10 (citing *Milan*, 2000 WL 1682761, at *5). None of these indicators are present in this case.

A more in depth analysis of *Milan*, which is relied on heavily by the Division, further establishes that the requisite indicia of fraud do not exist. Milan was an unregistered broker-dealer that collected investor money through its sales team at AC Financial based on Milan's false representation that it had access to IPOs through contracts with Morgan Stanley and Goldman Sachs, when in fact it had no access to IPO shares and never provided any IPO shares to customers. *SEC v. Milan Capital Group, Inc.*, 2000 WL 1682761, at *1-3 (S.D.N.Y. Nov. 9, 2000). The brokers at AC Financial used the false information provided by Milan to recommend the purchase of the IPO shares to investors.

The court found that AC Financial's sales manager's failure to investigate constituted reckless disregard for the truth in light of the following red flags: Milan's insistence on investors signing a Full Disclosure Agreement, which stated that funds would be placed in a 'self-induced pooled account' over which Milan had full discretion indefinitely -- contradicting prior verbal representations; Milan's instruction that the IPO share sales be concealed from AC Financial's Florida office; Milan's requirement that investor funds be wired to Milan, rather than AC Financial; and the crude, *<u>handwritten</u>* trade confirmations. *Id.* With respect to the failure to investigate based on the unusual Full Disclosure Agreement, the court found it compelling that a customer had drawn attention to the provisions and marked up his agreement to reflect restrictions on the sales as initially described to him prior to returning it. *Id.* at *6. It was also significant that the respondent played a central role in the fraud -- "not only did he personally solicit customers, he also was responsible for the supervision of the other brokers offering the IPO shares." *Milan*, at *5 (quoting *Infinity*, 993 F.Supp. at 330) ("Where a defendant plays a central role in marketing an investment, his defense that he was unaware that the investment was fraudulent is less credible.").

Livingston's conduct and *Milan* cannot be equated. First and foremost, Livingston was not in the type of supervisory role at issue in *Milan*. Furthermore, the offering documents were unlike those in *Milan* -- the documents were not inconsistent with verbal representations and, as the Division tended to point out, the investors were entitled to financial statements for the Four Funds and there is no evidence any such requests were rejected. There was also transparency in the sales at issue as opposed to the *Milan* requests to conceal the offerings, at least in Livingston's experience. And, the operations had every indication that they were legitimate: they were processed just as any other sale had been during Livingston's 20-year tenure with the firm, including with the approval of the firm's compliance and accounting departments. Ultimately, there were no red flags signifying obvious problems that should have alerted Livingston -- only green ones.

This is similar to the facts of *Howard*, in which the court reviewed an SEC order imposing sanctions for an offense that required scienter. *Howard v. SEC*, 376 F.3d 1136, 1147 (D.C. Cir. 2004) (finding no scienter when respondent relied on counsel, thus encountering "green flags" as opposed to "red flags"). The court concluded that the defendant did not act recklessly because he relied on the advice of counsel with respect to the transactions at issue. *See Id.* at 1147-49. In doing so, it explained that reliance on the expertise of a third-party is "evidence of good faith, a relevant consideration in evaluating a defendant's scienter." *Id.* at 1147. The court further noted that such reliance supports the conclusion that a defendant acted with " 'due care or good faith.' " *Id.* (citation omitted). Indeed, rather than ignoring red flags (which might indicate recklessness), the defendant "encountered green ones" because he relied on expert advice, resulting in the court vacating the sanctions order due to failure to establish scienter. *Id.*; *see also In the Matter of Lammert*, File No. 3-12386 , at *19 (April 28, 2008) (finding Division's purported red flags insufficient to establish liability for securities fraud).

Importantly, while the Division claims that glaring red flags in the PPMs should have caused the Respondents to do a further inquiry, those red flags and the need for additional inquiry was also not apparent to anyone else at the firm. *Cf. In the Matter of Raymond James Fin. Servs., Inc.*, No. 3-11692, at *51 (Sept. 15, 2005) (J. Murray) (rejecting argument that the majority of the situations identified by the Division were red flags when the evidence established no credible individual at the firm suspected the illegal scheme). In addition, the SEC examined the firm in 2004 and the NASD examined the firm in 2006 and then again in 2007, respectively, and examined the Four Funds and the PPMs. Like Respondents, those trained examiners did not see the supposed glaring red flags that the Division waives in hindsight and after a decade and discovery of the fraud through forensic analysis, nor did the examiners believe that heightened inquiry was necessary or suspect that wrongdoing was occurring.

3. The Division's Authorities Are Inapposite

While the Division claims that the "*Hanly, Giesige, Pinkerton,* and *Stires* cases are particularly relevant precedent," these opinions are inapposite. Br. p. 11. There are several distinguishing characteristics common to each case. First, these opinions involved the sale of sham offerings where no monies were invested in legitimate entities or programs. In contrast, the Trust Offerings did not fail because of any underlying problems with the investment themselves that Livingston could have known, but rather because the MS & Co. principals diverted funds for other purposes. Second, in all but one of the cases, the respondents had no information about the principal's background or the issuer's performance record, unlike Livingston who was a long-term MS & Co. employee and had first-hand knowledge of MS & Co. nearly thirty-year track record.

In addition, the Division's authorities all involve specific misrepresentations -- guarantees about what increases the investor would receive. *See, e.g., Hanly*, 415 F.2d at 593 (Company would double or triple; stock would probably double in price within six months to a year; prospects were good for earnings of $1 in a year; the stock would go from 6 to 12 in two weeks and to 15 in the near future.); *Pinkerton*, 1996 WL 602648, at *8 (three broker-dealers would make a market in the stock and take the price of the shares up to $8.00 to $10.00 a share; shares would double from the $3.00 unit offering price.). "In cases too numerous to cite, the Commission has consistently held that it is inherently fraudulent to predict specific and substantial increases in the price of a speculative security." *In the Matter of Giesige*, 2008 WL 4489677, at * (Oct. 7, 2008). In contrast, the Division merely alleges that Livingston made generalized misrepresentations (i.e., that the investments were safe and that MS & Co. had a proven track record) and even more generalized omissions about information it claims Livingston "should have" known.

Furthermore, even a cursory review of the cases relied on in the Brief demonstrate they are inapplicable. For example, *Giesige* involved an investment adviser who operated her own single proprietorship through her LLC. No. 3-12747, 2008 WL 4489677 (Oct. 7, 2008), *aff'd*, 2009 WL 1507584 (S.E.C. May 29, 2009). The Commission found that the respondent failed to conduct adequate due diligence before recommending securities to investors based on sales of interests she was told about during telephone conversations with a broker that she had located through an online search, resulting in third-tier monetary penalties of $500,000. *Id.* at *4. The respondent did not know much or anything about the broker's background or whether he held any securities licenses, unlike Livingston who knew Smith had a proven track record and was intimately familiar with his credentials. In a three-month span, the *Giesige* respondent offered and sold the subject securities to about 50 people who invested nearly $1.49 million after the respondent told them it was a good investment, despite the fact that she considered it an investment with substantial risk. *Id.* at *14. In comparison, during the five years prior to the Division initiating this action, Livingston allegedly sold the subject securities to 3 people who invested $255,000. And, in *Giesige*, even two years after the company that the interests were in was placed in receivership, the respondent continued to provide customers with false information, including representing that investors would get their investment back plus a profit. *Id.* at 5. Livingston, on the other hand, ceased selling any interests and disassociated himself with MS & Co. as soon as the "red flags" became apparent.

Similarly, in *Pinkerton*, a registered representative and sales manager sold and supervised the sale of securities issued by a company wholly-owned and operated by the president of the representative's firm. *Matter of Pinkerton*, 1996 WL 602648, at *2 (Oct. 18, 1996). The Division implies that the Commission found "the fact that the person who owned and controlled [the firm] also owned and controlled the issuer and was the only source of information about the issuer," constituted a "red flag," (Br. p. 13), the opinion actually notes that such a conclusion is attributable to the respondent's witness. *Id.* at *7. Moreover, the respondent did not disclose to customers that the issuer and broker-dealer were controlled by the same individual, unlike in Livingston. And, there were several other glaring red flags the Commission did consider. For example, the company paid brokers eleven percent commissions on the sales, with the firm permitting brokers to keep in the commissions in their entirety, as compared to the standard 2.5-5 percent commissions received for sales of other stocks, which were then shared half with the branch manager. *Id.* at *4. Likewise, while PPMs for the offering stated that the company was a health-care company that was developing nutritional supplements, anti-smoking products, and prototype vitamin, in actuality, the company had no operations, had no manufacturing capability, had no revenue, was located in the firm's offices, and only had one employee -- the firm's president. *Id.* at *3. Nevertheless, selling this particular security "was the main, almost exclusive, activity" for the respondent's office. *Id.* at * 4. The respondent also made detailed, deliberate misrepresentations, including that: the shares would trade publicly any day, shares would initially trade at a premium, three broker-dealers would make a market in the stock, those broker-dealers would take the price of the shares up to $8.00 to $10.00 a share, and the shares would double from the $3.00 unit offering price. *Id.* at *8.

Finally, as this Court is likely aware, the Division conveniently misquotes the holding from the *Stires* opinion, stating the registered representative and his firm were found to have violated the antifraud provisions for, among other things, '[recklessly] soliciting investors for private placement transactions that involved millions of dollars without validating information supplied by third party promoters.'" Brief p. 13 (quoting *Matter of Stires & Co., Inc.*, 1998 WL 462230, at *7 (J. Murray)). Importantly, the quote continues by stating "who [the representative] <u>*did not know*</u>..." *Stires*, 1998 WL 462230, at *7. Indeed, the respondent had never heard of the firm promoting the securities until he was introduced to them by his own client, and he never subsequently met his primary contact despite selling the securities for years. Furthermore, the promoter only provided a single page document that indicated it was a sub-agent authorized to sell the securities via private placement, which failed to identify the agent or the issuer. In contrast, Livingston worked with MS & Co. for over twenty years and he (at least thought that) he knew McGinn and Smith well. In addition, the finding was based on a laundry list of other activities, including deliberate misrepresentations made when the respondent reviewed, approved, and circulated offering materials that falsely represented that the firm's affiliate specialized in certain transactions that he knew the firm had never engaged in. *Id.* at *6.

C. Livingston Did Not Violate Rule 10b-5(a) and (c), or Securities Act Section 17(a)(1) and 17(a)(3)

The Division has not articulated its basis for the scheme liability claims asserted against Livingston, merely suggesting he was the "keystone of a scheme to defraud investors" based on his "robust sales efforts." Brief pp. 29-30. Assisting with five sales totaling $255,000 can hardly be deemed "robust sales." And, merely being a part of MS & Co. is insufficient to impose scheme liability, especially when the evidence establishes Livingston was not involved in the creation and management of the Four Funds or Trust Offerings, and was not directly linked to the deception at issue. *Cf. In the Matter of Vancock*, No. 34-61039A, 2009 WL 4026291, at *9 (S.E.C. Nov. 20, 2009).

To the extent the Division's scheme liability claims are based on the alleged misrepresentations that are offered in support of its fraud claims, it cannot prevail. Scheme liability under subsections (a) and (c) of Rule 10b–5 hinges on the performance of an inherently deceptive act that is distinct from an alleged misstatement. *SEC v. Kelly*, 817 F.Supp.2d 340, 344 (S.D.N.Y. 2011). Putting aside the fact that the Division has not established Livingston actually made any material misrepresentations or omissions, liability does not attach by merely repackaging fraudulent misrepresentations as a "scheme to defraud." *See SEC v. Goldstone*, 952 F.Supp.2d 1060, 1203-04 (D.N.Mex. 2013). Rather, scheme liability hinges on the performance of an inherently deceptive act that is distinct from an alleged misstatement. *SEC v. Kelly*, 817 F.Supp.2d 340, 344 (S.D.N.Y. 2011).

For example, in *SEC v. Lucent Techs., Inc.*, the court held that, because the sales at issue "were legitimate business transactions and the customers purchased the product from [defendants] with every intention of using it or selling it to end customers," the SEC's allegation that the defendants schemed to defraud by not disclosing certain details of the transactions was "nothing more than a reiteration of the misrepresentations and omissions that underlie plaintiffs [sic] disclosure claim." 610 F.Supp.2d 342, 360–61 (D.N.J. 2009). Similarly, in *U.S. SEC v. Benger*, a claim of scheme liability failed because, despite recognizing the scheme's complexity, the allegations offered in support of the 10b-5(a) and (c) claims merely described the misrepresentations that served the bases of the 10(b)-5(b) claims in different words. 931 F.Supp.2d 908, 915 (S.D.N.Ill. 2013). Likewise, in *Royal Dutch*, the plaintiffs alleged that defendant KPMG was primarily liable for its "active" participation in overstating the proved oil and natural gas reserves of its client, Royal Dutch Petroleum Company. *See* 2006 WL 2355402 at *2. The principal allegations against KPMG were that it had unfettered access to documents and employees of Royal Dutch and knew or recklessly disregarded that its client were improperly reclassifying reserves as proved in violation of the SEC guidelines. *See id.* at *6. The court first concluded that plaintiffs had failed to state a claim against KPMG under Rule 10b–5(b) because KPMG had not made the material misstatement or omission. *See id.* at *7. The court next dismissed the "scheme" claim under Rule 10b–5(a) and (c) because any deceptiveness alleged against KPMG resulted from the issuance of unqualified audit opinions and reports that violated accounting standards which was "nothing more tha[n] a misrepresentation claim." *See id.* at *10.

D. Livingston Did Not Act Negligently

The Division failed to establish Livingston should be liable for violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act based on alleged negligent conduct. As a preliminary matter, contrary to the Division's assertion, Section 17(a)(2)'s requirement that one obtain money or property through misstatements or omissions about material facts is not easily satisfied here. Br. n. 30. Livingston did not actually receive any commissions from the offerings -- rather he received a set draw. Putting that aside, according to Division's own evidence, Livingston only received a grand total of $700.00 in connection with the sales -- not thousands. *Id.*

Even still, the evidence reflects Livingston did conform with the applicable standards of care. He conducted due diligence with respect to both the Four Funds and the Trust Offerings. *See* Livingston's Proposed Findings of Fact and Conclusions of Law at 7-9. He saw no reason not to trust the experience and leadership of Smith and the MS & Co. staff, including its accounting department, CFO, and general counsel. The NASD and SEC conducted at least three examinations of MS & Co. during the relevant time period, yet failed to identify any of the "red flags" the Division now complains of. Tl Exs. 29, 103; Tr. 1230:8-1231:21. Livingston should not be deemed negligent for failing to detect purported signs that trained examiners could not.

E. Livingston Did Not "Willfully" Violate Section 5

Even if the Division can establish that the Four Funds and Trust Offerings were not exempt, it cannot show that Livingston willfully violated Section 5. For instance, it does not appear that the Division claims that Livingston was aware of the number of unaccredited investors, that the Four Funds exceeded 35 unaccredited investors, or that combining the Trust Offerings into two groups, that they exceeded 35 unaccredited investors.

Livingston relied on the representations of the issuer, the Funds' advisor (Smith), the MS & Co. compliance department, and outside counsel regarding the legality of the offering. TL

Exs. 1, 2, 17, 60. The Four Funds were expressly offered under Rule 506 of Regulations D, which allows for 35 unaccredited investors. TL Ex. 113 at 7. Patricia Sicluna knew of the limit on unaccredited investors and was responsible for tracking them. TL Ex. 17. Livingston was not aware that any of the offerings exceeded 35 unaccredited investors. Tr. 5237:3-21. Even if the Division can show a Section 5 violation by the firm, it cannot show that Livingston willfully sold unregistered securities because he had a good faith belief the offerings were properly exempt from registration.

F. Livingston Should Not Be Required to Pay Substantial Civil Monetary Penalties

The Division seeks "substantial penalties" based on contentions that Livingston "made numerous sales of different offerings in the five years preceding the filing of the OIP." Brief p. 40. However, according to the Brief, "Livingston [only] made 5 sales of 3 different offerings…from 3 investors." Br. p. 41. The Division's request should be denied because there is no evidence Livingston engaged in willful conduct or that such a penalty would be in the public interest. At a minimum, penalties should be limited to Tier-one as the Division has not established that Livingston acted with "deliberate or reckless disregard" of the securities regulations as required to impose Second Tier Penalties, let alone that his conduct (i) resulted in substantial losses, (ii) created a significant risk of substantial losses to other persons, or (iii) resulted in substantial pecuniary gain to Livingston as required to impose Third Tier Penalties. 15 U.S.C. 78u-2(c); *see also Rapoport v. S.E.C.*, 682 F.3d 98, 108 (D.D.C. 2012).

1. The Division Has Not Established Willful Conduct

While the Division focuses on whether the imposition of civil monetary penalties would be in the public interest, it wholly ignores the threshold requirement for imposing civil penalties. To impose penalties at all, the Court must find that Livingston 'willfully' violated the securities regulations. *Rapoport*, 682 F.3d at 108 (citing 15 U.S.C. § 78u–2(a)). The Division does not even allege that Livingston willfully violated any provision, merely concluding that "[t]hese unlawful sales warrant significant penalties." Br. p. 41. Accordingly, it has not met its burden. *See, e.g., Id.* (conclusory allegations that respondent willfully committed the violations insufficient to justify imposing second-tier penalties without further explanation); *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088 (D.D.C. 2005) (vacating award of third-tier sanctions upon finding the SEC failed to provide support for such imposition).

A defendant acts willfully when his actions are intentional, deliberate, and are not the result of an innocent mistake, negligence, or inadvertence. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 215 (1976) (holding defendant not liable under § 10(b) and Rule 10b-5 because negligence is not sufficient to prove intent requirement); *see also Messer v. E.F. Hutton*, 847 F.2d 673, 678-79 (11th Cir. 1988) (per curiam) (holding plaintiff did not prove willful intent on basis of defendant's arguably mistaken business judgment); *cf. United States v. Gross*, 961 F.2d 1097, 1102 (3d Cir. 1992) (upholding the conviction of a former company CEO who willfully falsified company records to inflate prices of its securities). While proof of specific intent is not needed, there is no evidence that Livingston had some evil purpose or intended to commit the prohibited act as required to establish a willful violation. *See, e.g., Gross*, 961 F.2d at 1102 (noting defendant inflicted enormous harm on many people purposely); *United States v. Schlei*, 122 F.3d 944, 967 (11th Cir. 1997) (finding intent where the defendant falsified financial records to sell forged Japanese government bond to investors).

2. Analysis of the Statutory Public Interest Factors Does Not Support the Imposition of a Bar

The Division's analysis of the six statutory factors relevant in the determination of whether civil monetary penalties are in the public interest is likewise misleading. The first factor, whether the act or omission "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," is a recognition by Congress that the Commission "may assess the violator's culpability, including whether the violator acted with scienter." Senate Report, at 14. The Division merely states that, because Livingston is charged with a violation of the antifraud provisions of the securities laws, he is presumed to have acted with "deceit, manipulation or deliberate or reckless disregard." Brief p. 42. The Division only provides one authority for such a proposition -- a case that does not rely on any other authorities this unreasonable proposition. If violations of such provisions automatically resulted in the imposition of a civil monetary penalty, the statute would state such. Besides, as discussed herein, there is no evidence that Livingston acted with such mental requisites.

The Division's contentions offered in support of the second and third factors, i.e., that penalties are in the public interest because Livingston "reaped significant financial rewards" thus caused great harm to investors, also ring hollow. Br. p. 43. At most, the alleged harm involves three individuals who unsuccessfully invested a total of $255,000. Moreover, the "unjust enrichment" claim is based on allegations Livingston received a grand total of **<u>$700</u>** -- an amount that was not even provided to him as commissions from the subject offerings, rather put towards his set draw.

In addition, the Division again attempts to muddy the waters by bringing up allegations regarding conduct that purportedly occurred prior to September 23, 2008. One of the relevant factors is "prior violations" -- it is not alleged prior misconduct. Specifically, Section 78u-2(c) entitled "Civil remedies in administrative proceedings" provides, in relevant part:

> In considering under this section whether a penalty is in the public interest, the Commission or the appropriate regulatory agency may consider --
>
> . . .
>
> (4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory

> organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 78s(b)(4)(B) of this title.

15 U.S.C. § 78u-2(b)(3). Therefore, the "Prior Unlawful Activity" discussion on pages 43 and 44 of the Division's Brief, which fails to identify any proven violations, is irrelevant.

The Division's reliance on *Brown* is equally misplaced. Br. p. 43 (citing *Matter of Brown*, No. 3-13532, 2012 WL 625874, at *14 (Feb. 27, 2012)). In *Brown*, the court reiterated that it could "not consider conduct that occurred before [the five-year limitations period] as violative conduct forming the basis for imposing a bar or civil penalty." *Matter of Brown*, 012 WL 625874 at *14. While conduct that occurred outside the statute of limitations may be considered to establish motive, intent, or knowledge in committing violations that occurred within the statute of limitations as discussed above, that does not mean that alleged prior misconduct may be considered in evaluating whether the imposition of a civil monetary penalty in the public interest. The statute is clear and unambiguous on this issue.

Interestingly, the Division also cites to *Warwick* for the argument that civil monetary penalties should be imposed on Livingston based on alleged prior "misconduct." Brief p. 43. As previously discussed, *Warwick* supports the proposition that prior misconduct must be "proven," not merely alleged, in order to be considered. 2007 WL 505772, at *2; *see also In re Next Financial Group, Inc.*, ("the Commission has held that it will not consider misconduct occurring more than five years before the OIP when imposing a civil monetary penalty") (citing *Johnson*, 87 F.3d at 488-9, and *3M Co. v. Browner*, 17 F.3d 1453, 1455-61 & n.14 (D.C. Cir. 1994)). Furthermore, the court determined it was not appropriate to impose <u>any</u> civil money penalties in *Warwick*, denying the Commission's request for second-tier penalties. *Id.* at *16.

Finally, the Division fails to set forth any evidence of the fifth factor, the need to deter, merely stating that "only significant penalties can have a proper deterrence effect here," without further explanation. Br. p. 44. The Division's citations offered in support of this proposition have no relationship to the facts at issue. The Division likewise failed to present evidence of other matters as justice may require as permitted under the sixth factor.

Ultimately, the precedent offered in the Division's Brief does not establish significant penalties are appropriate in this matter. For example, in *Matter of Giesige*, which the Division relies on heavily, the respondent was an investment adviser who operated her own single proprietorship through her LLC. No. 3-12747, 2008 WL 4489677 (Oct. 7, 2008), *aff'd*, 2009 WL 1507584 (S.E.C. May 29, 2009). The Commission found that the respondent failed to conduct adequate due diligence before recommending securities to investors based on sales of interests she was told about during telephone conversations with a broker that she had located through an online search, resulting in third-tier monetary penalties of $500,000. *Id.* at *4. The respondent did not know much or anything about the broker's background or whether he held any securities licenses, unlike Livingston who knew Smith had a proven track record and was intimately familiar with his credentials. In a three-month span, the *Giesige* respondent offered and sold the subject securities to about 50 people who invested nearly $1.49 million after the respondent told them it was a good investment, despite the fact that she considered it an investment with substantial risk. *Id.* at *14. In comparison, during the five years prior to the Division initiating this action, Livingston allegedly sold the subject securities to 3 people who invested $255,000. And, in *Giesige*, even two years after the company that the interests were in was placed in receivership, the respondent continued to provide customers with false information, including representing that investors would get their investment back plus a profit.

Id. at 5. Livingston, on the other hand, ceased selling any interests and disassociated himself with MS & Co. as soon as the "red flags" became apparent.

Instead, the authorities establish it is inappropriate to impose significant civil monetary penalties in proceedings of this nature, where the respondent has no prior violations, was not unjustly enriched, and caused relatively little injury. *See, e.g., In the Matter of Pinkerton*, No. 98, 1996 WL 602648 (Oct. 18, 1996) (cited by the Division) (finding respondent's actions involved blatant fraud, deceit, and a deliberate disregard of the law and regulatory requirements," but refusing to accept Division's recommendation to asses third-tier penalty because respondent "has not been the subject of any other findings of the type to be considered in making this public interest determination, and [respondent's] unjust enrichment of $28,380 was not substantial."); *In re Frey*, No. 221, Proceeding File No. 3-10310 (Feb. 5, 2003) (finding respondent violated Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, but declining to impose civil monetary penalties where respondent's action resulted mostly from his incompetence and ignorance, unjust enrichment resulted merely from commissions on very few trades, any prior violations were not serious, and only two customers testified and they did not lose their life savings or suffer great losses).

3. Penalties Should Not Be Imposed for Each Purportedly Violative Act

The Division's request for statutory civil penalties for each discrete "violation" of the securities law, in which it seeks separate third-tier penalties for what essentially amounts to one course of conduct, is unprecedented, especially in light of the relatively small amount of monies that properly could be considered Livingston's "ill-gotten" gains. In essence, the Division seeks a penalty of between $400,000 to upwards of $750,000, when Livingston's alleged "ill-gotten" gains during that same period was $700. In other words, the Division seeks a penalty that is 500 to 1,000 times his alleged commissions.

A survey of SEC enforcement actions confirms that the "per violation" approach the Division asks the Court to adopt in this case is highly disfavored. For example, in *SEC v. Robinson*, the court expressly rejected a "per violation" approach. The individual defendant was found liable under both the Securities Act and the Exchange Act for fraudulently inducing 207 investors to purchase stock through false and misleading material on the internet and in national advertisements. *Robinson*, 2002 WL 1552049, at * 1. Among other things, the defendant represented that his company's sales of security alarm systems were estimated to grow to $44 billion - despite the fact that the company had no product, no financing, and no manufacturing contract. Although the court described the defendant's conduct as "nothing but a polite form of theft" and his misrepresentations as "flagrant, indeed one might say outrageous" (*id.* at *5), and noted that he continued to make misrepresentations even after the court had entered a preliminary injunction against him, the court nonetheless imposed only a single third-tier penalty of $100,000. *Id.* at *12. The court flatly rejected the SEC's request for a $22.77 million civil penalty ($110,000 per violation, multiplied by 207 investors). *Id.* at *11.

Just a few of the multitude of additional authorities rejecting the Division's approach are as follows:

- In *SEC v. Opulentica, LLC*, 479 F. Supp. 2d 319 (S.D.N.Y. 2007), the defendant violated §§ 17(a), 5(a) and 5(c) of the Securities Act, and § 10(b) and Rule lOb-5 of the Exchange Act; the court imposed a single civil penalty of $120,000.

- In *SEC v. Wolfson*, No. 02 C 1086, 2006 WL 1214994 (D. Utah May 5, 2006), two defendants violated §§ 17(a), 5(a) and 5(c) of the Securities Act, and § 10(b) of the Exchange Act; the court imposed a single civil penalty of $110,000 on each defendant. Id. at **6, 7, 10.

- In *SEC v. Savino*, No. 01 C 2438, 2006 WL 375074 (S.D.N.Y. Feb. 16, 2006), the defendant - in connection with as many as 67 collusive trades over a two-year period-violated § 17(a) of the Securities Act, and § 10(b) and Rule 10b-5 of the Exchange Act, and aided and abetted another's violations of § 10(b) and Rule 10b-5; the court imposed a single civil penalty of $100,000.

- In *SEC v. Roor*, No. 99 C 3372, 2004 WL 1933578 (S.D.N.Y. Aug. 30, 2004), the defendant violated § 17(a) of the Securities Act and § 10(b) of the Exchange Act by making a "series of misstatements" over a six-month period; the court imposed a single civil penalty of $100,000.

- In *SEC v. Softpoint*, 958 F. Supp. 846, 868 (S.D.N.Y. 1997), the defendant violated §§ 17(a) and 5 of the Securities Act, and § 10(b) and Rules 10b-5 and 13b2-1 of the Exchange Act in connection with his participation in the preparation and dissemination of a company's misstated 1992, 1993, and 1994 public filings; the court imposed a single civil penalty of $100,000.

See also SEC v. Jones, No. 05 Civ. 7044(RCC), 2006 WL 1084276, at *12 (S.D.N.Y. April 25, 2006) (rejecting SEC's attempts to label each alleged violation -- collections of allegedly excessive fees -- as a new breach by the defendants).

This great weight of authority outweighs the handful of citations proffered by the Division for its request to multiply penalties by the number of victims (in this case, 3) or the number of investment products sold (in this case, 2). *See, e.g., In the Matter of Carley*, No. 8888, 2008 WL 268598, at *26 (Jan. 31, 2008) (noting calculation of civil penalty should not take into account conduct that occurred outside of the limitations period). And, the Division fails to provide a single authority for its contention that courts have imposed penalties on a "per sale" basis. Indeed, in *Bloomfield* (the case highlighted in the Brief), the court expressly declined to impose penalties based on each sale, instead multiplying by the number of security products. 2014 WL 768828, at n. 129 (Feb. 27, 2014).

Even putting these fatal flaws aside, none of the Division's cited cases provide authority for the its request for "per violation" or "per investor" civil penalties against Livingston, and they reiterate that the amount of the penalty should not exceed the amount of disgorgement. One of the cases, *Gerasimowicz*, 2013 WL 3487073, did impose a large monetary penalty of $1,950,000 taking into account the multiple investors, but that amount was nearly half of the ill-gotten gains that were subject to disgorgement. In addition, the penalty was imposed jointly and severally upon two entities and the individual respondent. *Id.* Similarly, in *Matter of Bandimere*, the Division alleged that the defendant made fifteen misrepresentations and omissions to multiple investors, and the court concluded that the Division had proven their case as to eight of those allegations, yet only three third-tier penalties were assessed. 2013 WL 5553898, at *84-5. And again, the total monetary penalty was close to half of the amount of disgorgement. *Id.* 82.

Furthermore, to the extent the Division is seeking additional penalties based on the sale of different investment products, such an argument is wholly inconsistent with the Division's position that offering integration is appropriate for the TDM Conduit Trusts and the MSF Conduit Trusts, pursuant to the Division's lengthy discussion of the five factors as to how the offerings were in fact one in the same. Br. pp. 5-7.

G. Livingston Should Not Be Barred from Working in the Industry

1. Pre-Limitations Conduct May Not Be Considered in Determining Whether to Impose a Bar From Working in the Securities Industry

It is well-established that the limitations under Section 2462 apply to the Division's request for an industry bar. *See, e.g., Johnson,* 87 F.3d at 488-90; *SEC v. Jones*, 476 F.Supp. 2d 374, 381 (S.D.N.Y. 2007); *SEC v. Mictrotune, Inc.*, 783 F. Supp. 2d 867, 885-86 (N.D. Tex. 2011); *SEC v. Bartek*, 484 Fed. Appx. 949, 955 (5th Cir. 2012); *SEC v. DiBella*, 409 F. Supp. 2d 122, 128 n. 3 (D. Conn. 2006). The Division again seeks to side-step these authorities by suggesting the court should consider past alleged misconduct, citing *Warwick*. Again -- *Warwick* only indicates that such conduct should be considered in determining sanctions if violations are *proven*. *Matter of Warwick Capital Mgmt, Inc.*, 2007 WL 505772. The Division cannot identify any previous established violations, especially any that involve fraud.

Simply put, more than 90% of the alleged violations upon which the Division described in its Brief were untimely. Once the alleged untimely violations are excluded as required by

Section 2462, only five trades remain. To forbid Livingston from forever participating in the securities industry under such circumstances would be draconian.

2. Sanctions Imposed Upon Respondent Feldmann are Irrelevant

It is disingenuous, at best, for the Division to suggest that it is appropriate to bar Livingston because a bar was imposed on Respondent Richard Feldmann. Brief p. 47. Feldmann is 74 years old and left the securities industry in 2010. Rather than incurring the expense to litigate, Mr. Feldmann submitted an Offer of Settlement in which he agreed to a securities industry bar and the monetary relief sought by the Division. Contrary to the Division's suggestion, the Commission did not adjudicate the claims against Mr. Feldmann, but merely accepted the factual recitations in Mr. Feldmann's Offer of Settlement, which the Commission made clear were not binding on anyone else in this proceeding. *Matter of Anthony, et al.*, No. 3-15514, 2014 WL 1320384, at *1 (April 3, 2014). Likewise, Feldmann sold approximately $5.4 million of the Four Funds offerings and approximately $595,000 of the Trust Offerings, earning approximately $299,000 in commissions. In contrast, Livingston is charged with selling $255,000 of the Trust Offerings, earning approximately $700 in commissions. Above all, the bar was imposed as a result of a settlement agreed to by Feldmann, not a decision of the Court after evaluating the merits. *Id.*

3. Analysis of the Steadman Factors Does Not Support the Imposition of a Bar

Contrary to the Division's liberal interpretations, the application of the *Steadman* factors to the claims against Livingston establish it is inappropriate to impose a securities industry bar as there are no allegations of the sort that is normally deemed to merit the imposition of injunctive relief.[5] A permanent bar has been deemed "the most drastic sanction at the Commission's

[5] *Compare SEC v. Colonial Inv. Mgmt.*, LLC, No. 07 Civ. 8849 (PKC) 2008 WL 2191764, at *3 (S.D.N.Y. May 23, 2008) (denying motion to dismiss where it was alleged that "defendants repeatedly [on eighteen separate occasions]

disposal" and may only be imposed if the Commission "articulates carefully the grounds for its decision, including an explanation as to why lesser sanctions will not suffice." *Steadman*, 603 F.2d at 1142. While the egregiousness of Messrs. Smith and McGinn's misconduct may be "well-established," their acts should not be imputed on Livingston or the other respondents. *See, e.g., Matter of Graystone Nash, Inc.*, No. 3-8327, 1996 WL 360258, at * (June 27, 1996) (noting respondent should not be held accountable for possible wrongdoing of others and finding no violation of Section 10(b) of the Exchange Act or Rule 10(b) thereunder or other related sections of the securities laws). The allegations against Livingston do not involve "many years while handling millions of investors' dollars"; rather they are about $255,000 worth of investments received from three investors.

As discussed herein, the actions that serve the basis of the Division's claims establish Livingston was, at most, negligent. "It would be a gross abuse of discretion to bar a [financial professional] from the industry on the basis of isolated negligent violations." *Steadman*, 967 F.2d at 1141 (remanding case in which Commission imposed permanent disbarment for violation of 10(b) and 17(a) based on failure to disclose conflicts of interest in loans). Furthermore, even if Livingston is found to have acted recklessly or with a higher level of culpability, analysis of the remaining factors indicates he should not be subject to a bar. *See SEC v. Snyder*, Civ. A. No. H-03-04568, 2006 U.S. Dist. LEXIS 81830, at *18-27 (S.D. Tex. Aug. 22, 2006) (although defendant acted with scienter and had an economic stake in the violation, a bar was "unnecessary and unwarranted" in light of the lack of egregiousness, the isolated nature of the actions, and the strong unlikelihood of defendant ever obtaining another officer/director position or committing future violations.); *compare Vancook v. SEC*, 653 F.2d 130 (2011) (imposing permanent bar

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and knowingly engaged in conduct that violated [securities regulation] over a period of several years" and engaged in sham transactions to cover-up violations); *SEC v. Power*, 525 F. Supp. 2d 415, 427 (S.D.N.Y. 2007) (similar).

from any association with a broker dealer or registered investment company when defendant knowingly devised a scheme to manipulate the process through actions that he knew to be illegal and was even advised such by his counsel); *In re Lodavina Grosnickle*, 2011 SEC LEXIS 3969 (Nov. 10, 2011) (bar warranted when defendant knowingly made false representations that the investments were secured by bank guarantees to approximately 33 investors, and committed several specific deceitful acts in furtherance of the fraud). At a minimum, any bar should be of limited duration -- as established by the Division's own authorities. *See, e.g., In the Matter of Stires & Co., Inc.*, No. 3-9120, 1998 WL 462230, at *14 (Aug. 11, 1998) (rejecting the Division's recommendation that the respondent be barred for a "substantial period," instead imposing 90-day bar despite finding violations of securities statutes involved fraud and recklessness); *see also In the Matter of Anthony Cipriano*, 2007 WL 2229587, at *12 (July 26, 2007) (modifying sanctions imposed by hearing panel upon finding two-year suspension was too harsh when misconduct involved sales of approximately $10,000 to only a handful of customers).

The critical question in determining whether an injunction is warranted is whether there is a reasonable likelihood of future violations by the defendant. *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1100 (2d Cir. 1972). In order to establish a likelihood of recurrence that requires a permanent injunction and bar, the Division must "go beyond the mere facts of past violations and demonstrate a realistic likelihood of recurrence." *Jones*, 476 F. Supp.2d at 384; *see also Steadman*, 967 F.2d. at 648 (SEC must establish "some cognizable danger of recurrent violation" to sustain an injunctive claim). There is no evidence – nor any allegation – that Livingston has engaged in any misconduct since he left MS & Co. in 2009, and nothing demonstrates that he is likely to do so in the future. *See Jones*, 476 F. Supp.2d at 384 (fact that "several years have passed since Defendants' . . . misconduct apparently without incident . . . undercuts [SEC's] assertion that Defendants pose a continuing risk to the public"); *Proffitt v. FDIC*, 200 F.3d at 861 (same); *Johnson v SEC*, 87 F.3d at 490 n.9 (same). Livingston does not have any retail clients nor does he intend to do any retail business in the future. Tr. 5176:8-14. He is currently employed by Halliday Financial Group, where he runs its capital markets group. Tr. 5172:24 - 5173:2, 17-21. Livingston deals exclusively with underwriting SEC-registered securities in transaction primarily led by the US's major banks, including Merrill Lynch, J.P. Morgan Chase, Wells Fargo, and Morgan Stanley. The bulk of the transactions in which Livingston is involved are fixed income securities, such as preferred stocks issued by large companies, and structured products that are FDIC insured. He is not involved in underwriting or selling unregistered securities, including private placements. Tr. 5174:6 - 5176:7.

The Court heard testimony about Livingston's strong attitude towards compliance. Andrew Halliday, Livingston's supervisor, testified that Livingston rather not do a deal than do it in any way, shape, or form that is in a grey area. Tr. 5919:16 - 5920:2. He discussed the fact that in connection with FDIC-insured structured products offered by Halliday, Livingston insisted the that firm go beyond FINRA requirements and make extra disclosure to the potential investors. Tr. 5920:3 - 5921:21. Livingston has a very strong reputation for integrity and truthfulness in the community. Tr. 5922:7 - 18. He has been described as being very prudent, very careful, takes the careful route every time. Tr. 5883:6-7. Simply, Livingston is a man of "impeccable" character. Tr. 5882:17 - 24.

In addition, even assuming, arguendo, the allegations about Livingston's past conduct were admissible, it would be insufficient to sustain the Division's request for a bar. *See, e.g., SEC v. Commonwealth Chem. Sec.*, 574 F.2d 90, 100 (2d Cir. 1978) ("recent decisions have emphasized[] ... the need for the SEC to go beyond the mere facts of past violations and demonstrate a realistic likelihood of recurrence"; a prior violation is relevant only to the extent it "indicates . . . that there is a reasonable likelihood of further violations in the future") (quoting Louis Loss, 3 Securities Regulation 1976 (1961)) (internal citations omitted); *SEC v. Bausch & Lomb, Inc.*, 565 F.2d 8, 18 (2d Cir. 1977) (SEC "cannot obtain [injunctive] relief without positive proof of a reasonable likelihood that past wrongdoing will recur"); *SEC v. Tandem Mgmt., Inc.*, No. 95 Civ. 8411 (JGK), 2001 U.S. Dist. LEXIS 19109, at *39 (S.D.N.Y. Nov. 13, 2001) ("The dispositive issue is simply whether there is a likelihood of future violations without an injunction. . . . past violations are relevant to this question but do not necessarily dispose of it.") (internal citations omitted).

Likewise, the Division makes no claim concerning Livingston's current competence to serve in the securities industry. *See Microtune*, 783 F. Supp. 2d at 885 (finding requested relief was punitive where it was based solely on defendant's past conduct with no attempt to evaluate his present fitness or competence); *Johnson*, 87 F.3d at 490 (finding Commission's failure to cite a single piece of evidence that suspension was necessary due to plaintiff's current unfitness to be supervisor weighed against finding risk of future violation). Moreover, as in *Microtune*, the Division's delay of over three and a half years in initiating proceedings to enjoin and suspend Livingston is inexplicable if it truly viewed him as a future danger to the investing public.

III.
CONCLUSION

Based on the foregoing, Respondent Thomas Livingston respectfully requests that this Court enter the Proposed Findings of Fact and Conclusions of Law of Respondent Thomas Livingston, and grant all other relief to which he may be justly entitled, whether in law or equity.

Respectfully submitted

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