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.

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DIVISION OF ENFORCEMENT'S MEMORANDUM OF LAW IN OPPOSITION TO RESPONDENTS' MOTIONS TO CORRECT THE INITIAL DECISION

The Division of Enforcement respectfully submits this memorandum in law in opposition to: (1) Respondent Frank Chiappone's Motions to Correct Manifest Error of Fact and to Submit Additional Evidence, filed March 3, 2015; (2) Respondents Philip S. Rabinovich and Brian T. Mayer's Motion to Correct the Initial Decision, filed March 5, 2015; (3) Respondent William F. Lex's Motion to Correct Manifest Errors of Fact, filed March 6, 2015; and (4) Respondent Thomas Livingston's Motion to Correct the Initial Decision, filed March 6, 2015.

PRELIMINARY STATEMENT

Respondents' motions to correct should be denied. First, the Initial Decision properly calculates commissions received after February 1, 2008, the date by which the Court found the moving Respondents had the requisite scienter to commit securities fraud. Although one line in the Initial Decision orders disgorgement of commissions earned on "sales" after February 1, 2008 (Initial Decision ("ID") at 115), Respondents' argument based on that single word *is*

undermined by the actual amounts ordered to be disgorged (ID at 115, 117-118), which represent payments received after February 1, 2008; the findings in the Initial Decision that Respondents were reckless at least after February 1, 2008; and caselaw establishing that proceeds of a fraud should be disgorged. Consequently, acceptance of Respondents' argument would yield a perverse unintended result: Respondents would get to pocket post-February 1, 2008 commissions that they knew were fraudulently generated.

Second, Lex's and Livingston's motions—focusing in part on characterizations of another proceeding and the link between a sale and a commission payment, respectively—do not identify a patent misstatement of fact. Rather, Lex and Livingston urge that different conclusions be drawn from the evidence and, as such, raise issues that cannot be resolved in a Rule 111(h) motion to correct.[1]

ARGUMENT

I. The Initial Decision Properly Deprives Respondents of Ill-Gotten Gains Received After February 1, 2008

The Initial Decision was correct to deprive Respondents of ill-gotten gains they received after February 1, 2008, the date on which the Court found all moving respondents "had requisite scienter to violate the antifraud provisions." *See* ID at 115. To adopt moving Respondents' argument—that they should get to keep commissions made on pre-February 1, 2008 sales but received thereafter[2]—would mean moving Respondents could keep commissions with the

[1] Respondents filed their motions under a number of SEC Rules of Practice, including Rules 111(h) (Lex), 410 (Livingston, Rabinovich and Mayer, and Chiappone), and 452 (Chiappone). All of the motions seek to correct what moving Respondents claim to be errors in the Initial Decision. Accordingly, the Division treats the motions as filed under Rule 111(h).

[2] Respondents describe the commissions at issue as "trailing commissions," apparently referring to a feature of the Four Funds' PPMs stating that commissions would be paid "at the rate of 2% of the aggregate principal amount of the notes per year over the term of the notes." Div. Exs. 5 at 13 (FIIN); 6 at 13 (FEIN); 12 at 13 (FAIN); and 9B at 11 (TAIN).

knowledge, upon receipt, that they were generated fraudulently. As the Court noted, February 1, 2008 was "almost a month after Selling Respondents learned about the Four Funds' junior note default and that Smith had misled them regarding the Four Funds' diversification, investments in alseT, and conflicts." *Id.* To permit moving Respondents to continue to collect commissions from sales of those same Four Funds notes would be inconsistent with disgorgement's equitable purposes.

Disgorgement remedies securities law violations "by depriving violators of the fruits of their illegal conduct." *SEC v. Contorinis*, 743 F.3d 296, 301 (2d Cir. 2014) (affirming disgorgement award) (citations omitted). It deters subsequent fraud and, importantly, makes the illicit action *unprofitable* for the violator. *Id.* Indeed, disgorgement's equitable reach extends beyond violators: courts routinely order relief defendants to disgorge their ill-gotten gains even in situations where those persons are entirely ignorant of the underlying fraud. *See, e.g., SEC v. Aronson*, No. 11 Civ. 7033(JSR), 2013 WL 4082900, at *13 (S.D.N.Y. Aug. 6, 2013) (ordering relief defendant with no knowledge of underlying fraud to disgorge ill-gotten gains); *see also SEC v. China Energy Sav. Technology, Inc.*, 636 F. Supp. 2d 199, 204 (E.D.N.Y. 2009) (explaining, in ordering disgorgement of relief defendants' ill-gotten gains, that "knowledge of the alleged fraud is not a requirement for ... [disgorgement] from relief defendants.") (citing *SEC v. Cavanagh*, 155 F.3d 129, 137 (2d Cir. 1998)). It cannot be the case that unknowing relief defendants have to disgorge all ill-gotten gains but registered representatives may keep commissions that they know are fraudulently gained upon receipt.

The adoption of moving Respondents' disgorgement calculations is not only inconsistent with the Initial Decision's clear goal of depriving those Respondents of the fruits of their illegal

conduct, but fails to make their illicit actions unprofitable. As shown in the table below, moving Respondents' methodology drastically reduces the disgorgement amount:

Respondent	Initial Decision Disgorgement Award	Respondents' Revised Disgorgement Figure	Difference
Chiappone	$103,800	$62,853	$40,947
Lex	$335,066	$169,375	$165,691
Livingston	$1,120	$700[3]	$420
Mayer	$34,962	$29,518	$5,444
Rabinovich	$158,542	$109,695	$48,847

Further, it permits Respondents to keep hundreds of thousands of dollars in aggregate profits reaped through their post-February 1, 2008 knowing participation in a fraudulent scheme. Such a result is inconsistent with the findings presented in the Initial Decision and with the purpose of disgorgement awards.

The Division agrees with Respondents that the Initial Decision's use of the word "sales" after February 1, 2008 (ID at 115), and its calculation of commissions both in the text of the decision and in the Order itself (ID at 115, 117-118)—which show commission payments after that date—requires clarification. For the reasons presented above, however, the Division respectfully urges Your Honor to clarify that disgorgement is ordered of "all commission payments *received* on or after February 1, 2008" and to retain the disgorgement figures presented in the Initial Decision.

II. Lex and Livingston Raise Issues that Cannot Be Resolved by a Rule 111(h) Motion to Correct

Lex and Livingston question other parts of the Initial Decision, but fail to identify a patent misstatement of fact, as required to prevail on a motion to correct. "A motion to correct a manifest error is properly filed *only* if the basis for the motion is a patent misstatement of fact in

[3] As discussed in Section II, Livingston makes further, unsupported arguments as to why he should not have to disgorge a penny for his role in the fraudulent scheme, which should be rejected as improper fodder for a motion to correct.

the Initial Decision." *In re Hirsch et al.*, No. 3-14394, Rel. No. 683, 2011 WL 10902135 (ALJ Order Oct. 7, 2011) (Murray, J.) (emphasis added) (citing 17 C.F.R. § 201.111(h)). A patent misstatement of fact is "readily visible or intelligible: obvious." *Id.* (citing Merriam-Webster's Collegiate Dictionary 849 (10th ed. 2001)). Rather than identify an obvious error, both Lex and Livingston appear to be urging the Court to draw different conclusions from the evidence.[4] Accordingly, the Division respectfully submits that their motions should be denied.

A. Lex's Unfounded Attack of the Initial Decision's Wording Choice Should be Rejected

Lex raises improperly in a motion to correct the Initial Decision's statement that the arbitration panel in *In re Chang*, FINRA No. 08-04924, "derided Lex for failing to diversify Chang's holdings." *See* Lex. Mot. at ¶15 (citing ID at 37). The Initial Decision's characterization of the FINRA decision is not an obvious error: the FINRA panel faulted Lex for the overconcentration of the Chang's assets in McGinn Smith & Co., Inc. ("MS & Co.") private placement notes and stated that this overconcentration was exacerbated by Mr. Lex's lack of knowledge of his clients' liquid assets. *See* Div. Ex. 514 at 3-4. In December 2009, a FINRA arbitration panel ordered Lex to pay $805,110, jointly and severally with David Smith and MS & Co., to the Changs. *See* Div. Ex. 514 at 4. In October 2010, FINRA suspended Lex for failure to pay the Chang arbitration award. Div. Ex. 482 at 10. Lex has never made any payments to the Changs to satisfy the arbitration award. Tr. 1538:19-24.[5]

[4] Similarly, Chiappone's Motion to Submit Additional Evidence does not appear to offer any new facts, but rather highlights the facts already in evidence on which Chiappone asks the Court to focus. As such, the Division does not oppose the Court's consideration of Chiappone's versions of the already admitted evidence but rejects his conclusions—that his disgorgement figure should be reduced—for the reasons explained above.

[5] Citations to "Tr. __" are to pages in the Hearing Transcript in this case.

The Initial Decision's choice of the word "deride" is not a "fact" and was made after a review of the evidence, and thus cannot form the basis for a motion to correct. *See In re Leaddog Capital Markets, LLC et al.*, No. 3-14623, Rel. No. 726, 2012 WL 8718377, at *1 (ALJ Order Sept. 25, 2012) (rejecting motion to correct where respondents urged Court to draw a different conclusion from the evidence). Moreover, Lex's focus on the Initial Decision's word selection in presenting the FINRA arbitration decision has no effect on the outcome of this proceeding or the relief awarded because the Initial Decision found numerous independent bases to hold Lex liable for securities fraud. Accordingly, Lex's motion should be denied.

B. Livingston's Attempt to Avoid Disgorging Ill-Gotten Gains Altogether Should be Rejected

Livingston attempts to re-litigate the disgorgement award, arguing that he did not receive a single penny of ill-gotten gains during his years as a principal and registered representative at MS & Co. Livingston's argument that "there is no evidence that [the February 15, 2009 $700] payment related to the sale of TDMM Cable 09" does not identify a single misstatement of fact and instead urges that a different conclusion be drawn from the evidence.[6] *See* Livingston Mot. at 2. Tellingly, Livingston fails to present any evidence that the Division's summary witness, Kerri Palen, "assumed" that the $700 payment related to a TDMM Cable 09 sale, as opposed to reviewed and summarized underlying payroll records. *See* Livingston Mot. at 2.

The Initial Decision adopts Palen's statements as to commissions paid to Respondents without modification, and states that Palen's source material included, among other things, payroll records. *See* ID at 69 & n.85; *see also* Div. Ex. 2 at ¶¶ 16-17 (describing commission calculation methodology). Palen Exhibit 4n (Div. Ex. 2 at 109) is a schedule showing the

[6] Livingston's motion neither disputes that he sold a $20,000 TDMM Cable 09 9% certificate on January 29, 2009 nor that he received a payment of $700.

commission payments to Mr. Livingston. Tr. 260:16-21. As Palen explained during the hearing, Palen Exhibit 4n "shows the date of the payment, the description that was on the bimonthly payroll, commission schedule, and the amount that was paid to Mr. Livingston." Tr. 260:22–261:3. Palen relied on additional source materials, including detail commission schedules, to create Palen 4n and "those sources were sent to Mr. Livingston's counsel after he asked [the Division] for them." Tr. 261:4-11. Evidentiary conclusions cannot be attacked in a motion to correct and Livingston's motion should be denied.

CONCLUSION

Based on the foregoing, the Division respectfully requests that the Commission deny Respondents' motions to correct the Initial Decision.

Dated: New York, NY
March 20, 2015

Respectfully submitted,

DIVISION OF ENFORCEMENT

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CERTIFICATE OF SERVICE

I, Haimavathi V. Marlier, hereby certify that on March 20, 2015, I caused the following document, Division of Enforcement's Memorandum of Law in Opposition to Respondents' Motions to Correct the Initial Decision, to be sent by email and UPS Next Day Air to (original and three copies):

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Re: ***Matter of Anthony, et al.*, File No. 3-15514**

Dear Ms. Murphy:

We enclose an original and three copies of the Division of Enforcement's Memorandum of Law in Opposition to Respondents' Motions to Correct the Initial Decision.

Respectfully submitted,

Haimavathi V. Marlier

cc: The Honorable Brenda Murray, Administrative Law Judge

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