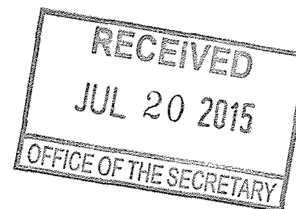

SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15514

In the Matter of

FRANK H. CHIAPPONE,
ANDREW G. GUZZETTI,
WILLIAM F. LEX,
THOMAS E. LIVINGSTON,
BRIAN T. MAYER, and
PHILIP S. RABINOVICH,

Respondents.

RESPONDENT WILLIAM F. LEX'S INDIVIDUAL BRIEF

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PRELIMINARY STATEMENT

William (Bill) Lex is 69 years old. For over 40 years he worked in the insurance business without a claim or blemish on his record. He was trusted by everyone who knew him and with whom he did business, known by his customers as an honest man, conscientious, wanting to do what was best for his customers about whom he cared deeply. He never offered products (insurance, variable annuities, or private placements) which he would not purchase for himself and his wife, or recommend and sell to his children, his in-laws, or his dear friends. He is a man of devout faith and conscience. It was his character for honesty which enabled him to build up longstanding relationships with customers of all walks of life – everyday working people, as well as professionals, physicians, hospital executives and other professionals. By 2003, he had an active customer roll of over 2,000 people, of which 50 to 75 were purchasers of McGinn-Smith pre-AISG (2003) Alarm Notes. The rest were almost all insurance or variable annuity customers. As the ALJ found, Mr. Lex watched the performance of the Alarm Notes for several years, then bought them for himself, and after a year began offering them to customers around 1996.

Bill Lex watched the success of virtually all of the private placement products which were issued by McGinn-Smith over a period of more than 20 years. These products always paid on time and always redeemed on time. Then the Four Funds came out, and for five years, 2003 to 2007, inclusive, continued to follow that pattern of paying interest on time and redeeming on time.

McGinn-Smith was not a new broker-dealer in 2003. With at least 23 years of successful operations and with McGinn and Smith viewed important pillars of the Albany community, and having dealt with large and reputable investment banking firms, Bill Lex had great trust and

respect for both these individuals and felt confident in their ability to continue to manage successful offerings.

It is in this context that the actions of Bill Lex, as well as the other Respondents, must be viewed.

Of course, we now know since the 2010 shut-down of McGinn-Smith and SEC investigation, and the McGinn and Smith criminal trial, that McGinn and Smith were engaged in various unlawful schemes to keep products afloat and to line their own pockets.

With the substantial investments of Bill Lex and his wife in the Four Funds – Bill Lex invested $400,000.00 in the first Four Funds offering – and with purchases by his children, his in-laws, and dear friends, it is impossible to comprehend how Judge Murray or this Commission could allow the label of "fraud" to be placed upon Bill Lex's shoulders. Added to these facts is the Division's own expert witness, Kerri Palen, who testified that she found no evidence that Bill Lex or the other Respondents had knowledge of McGinn and Smith's fraud or manipulations or that they benefited from McGinn and Smith's theft and manipulation of proceeds. The effect on Bill Lex's life is not softened by the ALJ's blithe use of the word "reckless," a wholly subjective term, not justified by the facts in this case.

Notwithstanding this history, the ALJ inferred in every situation that Lex's conduct was consistent with fraud, and not that Bill Lex was deceived like so many others were for so many years, and that he honestly believed in the products he sold.

ARGUMENT

William Lex, in submitting this individual brief, incorporates by reference herein the arguments made in the Joint Brief submitted contemporaneously herewith.

Respondent William F. Lex asks the Commission to reverse the Initial Decision ("I.D.") of Chief Administrative Law Judge Brenda Murray, dated February 25, 2015, as amended by the Order of April 9, 2015, and to dismiss the entire proceeding. The Judge found Mr. Lex liable under the federal securities laws in connection with the sale of certain private placements issued by McGinn Smith & Company, for which he was a registered representative and independent contractor.

Through a civil suit against McGinn Smith and a criminal suit against its principals, it was eventually learned that Timothy McGinn and David Smith were fraudulently diverting funds of McGinn Smith investors. But, as the Administrative Law Judge acknowledged: "The Division's expert had no reason to believe that Respondents [including Respondent Lex] were aware of McGinn and Smith's fraud. Tr. 1220." (I.D. at 4.) Nevertheless, the Administrative Law Judge found Mr. Lex liable under Section 5 of the 1933 Securities Act and the anti-fraud provisions of the Securities Act and the 1934 Exchange Act.

As set forth below, the Commission should reverse the decision and dismiss the proceedings because there were numerous prejudicial errors in the conduct of the proceeding, there were numerous clearly erroneous findings and conclusions of material fact, and there were numerous erroneous conclusions of law which are identified below.

I. As a matter of law, no alleged omissions or misrepresentations were material because it is undisputed that all pertinent risks of the investments were set forth in writing in the PPMs and Subscription Agreements.

A. SUMMARY OF ARGUMENT

We begin with the obvious. This is not a suitability case. It was not pleaded as such, and could not be tried as such. This case involves allegations of securities fraud and violations of §5 of the Exchange Act for sale of unregistered securities.

Judge Murray found Mr. Lex to have violated "willfully Securities Act § 17(a)(1) and Exchange Act 10(b)(5) and Rule 10(b)(5), stating that:

> "The preponderance of the evidence is that Lex was reckless in offering and selling securities based on material representations that he made to the witnesses who purchased private placements."

The fact is there were no material misrepresentations made by Mr. Lex which could result in a finding of securities fraud under any of the statutes or rules.

Judge Murray's findings against Mr. Lex are neither supported by the evidence, nor has she drawn appropriate inferences from the evidence. There were no affirmative material misrepresentations.

It appears that most, if not all, of Judge Murray's complaints about "non-investigation" relate to the Four Funds, claims clearly barred by the statute of limitations. The Judge's indiscriminate mixing of the trusts with the private placements to establish securities fraud is completely improper. As to the finding that an investigation was required because of the risks of the private placements, and her finding that the clients should have been informed of the risks of the private placements, the fact is that all of the private placements, including the trusts, provide extensive explanation of the risks inherent in the investments. As to the conflicts of interest, they were disclosed in the offering memoranda, and were neither red flags, nor did they require further explanation. As Charles Bennett, expert for William Lex, testified, the explanation in written materials that there will be conflicts of interest is not a red flag since it informs the

investor in advance of actions which may be taken by the issuer. As to transactions with affiliates, these were all disclosed. These disclosures were not red flags or the cause of the losses suffered. Rather, it was the abuses of McGinn and Smith with respect to this permissible conduct which resulted in the losses.

As to the disclosures of Four Funds investments in August of 2007, all of which was before September 23, 2008, not only is this barred by the statute of limitations, and therefore irrelevant, it was also waived by the SEC in pre-trial proceedings. (See Argument below) Nevertheless, Mr. Lex explained that he was satisfied with Mr. Smith's explanation for the change in policy. This, too, was not "indicative of fraud." Here again the Judge draws an inference of wrongdoing when it is at least as plausible that Mr. Lex believed the reasons given were reasonable in light of the financial world in late 2007 and 2008.

B. There Were No Material Misrepresentations or Omissions

The ALJ's findings of omissions and misrepresentations by Lex are centered on his alleged failure to inform his clients that the McGinn private placements were risky, and his alleged statements that they were safe. (I.D. p. 103.) Lex denies that he characterized the investments as safe, but because the clients all received written materials that were replete with prominent warnings about the high risk of the investments, and because the investors all signed Subscription Agreements acknowledging their understanding of the high-risk nature of the investments, any alleged oral statements or omissions to the contrary are not material as a matter of law.

Under the materiality requirement for securities fraud, the allegedly false statement or omission must be one "that a reasonable investor would have considered significant in making investment decisions." Ganino v. Citizens Utilities Company, 228 F.3d 154, 161 (2nd Cir. 2000),

citing Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988). Accord, Marini v. Adamo, 2014 WL 465036 at *23 (E.D. N.Y. 2014); In re Longtop Financial Technologies Limited Securities Litigation, 939 F.Supp.2d 360, 376 (S.D.N.Y. 2013). Where all pertinent disclosures are set forth in a written PPM made available to the investor, the investor is bound with knowledge of those disclosures. Brown v. The E.F. Hutton Group, Inc., 991 F.2d 1020 (2nd Cir. 1993)(defendants allegedly orally characterized investments as "conservative" and "low risk"; affirming summary judgment for defendants because "the alleged oral statement are contradicted by the offering materials"); Mercury Air Group, Inc. v. Jet USA Airlines, Inc., 1998 WL 542291 at *7 (S.D.N.Y. 1998), aff'd, 189 F.3d 461 (2nd Cir. 1999)(dismissing securities claim because the private offering memorandum "clearly contradicts the alleged oral representations"). Therefore, as long as the investor has all pertinent truthful information in the written offering materials, any alleged oral omissions or representations to the contrary are legally insignificant and immaterial. Acme Propane, Inc. v. Tenexco, Inc., 844 F.2d 1317, 1322 (7th Cir. 1988).

"Where the facts and circumstances allegedly omitted or misrepresented have actually been disclosed in the relevant transaction document, there is no liability under the securities laws because the materiality element is absent." Taylor v. Prudential Insurance Company of America, 2003 WL 21314254 at *7 (S.D. Ind. 2003). See also, Wamser v. J.E. Liss, Inc., 838 F.Supp. 393 (E.D.Wisc. 1993.

In In the Matter of VMS Limited Partnership Securities Litigation, 1992 WL 249594 (N.D. Ill. 1992), plaintiffs alleged that the defendants violated the securities laws by orally characterizing certain investments as "secure," "conservative," and "reasonably expected to be profitable," when they were in fact highly risky. Id. at *11. In dismissing all claims, the court held that the materiality element was lacking as a matter of law because (as in this case) the

alleged oral misrepresentations were contradicted by the numerous written warnings in the private placement memoranda and subscription agreements.

The PPM in VMS (as in this case) explained that "[i]nvestment in the units involves a high degree of risk" and is suitable only for persons who "could withstand a loss of their entire investment in the Units." VMS at *11. As in this case, the investors in VMS "warranted that they had reviewed the offering materials when they signed their subscription agreements." Id. at *14. The VMS court continued:

> Moreover, by signing the subscription agreement, plaintiffs expressly acknowledged that "the Units are speculative investments which involve a high degree of risk of loss by the undersigned of his entire investment." Hence, disclosures about the risky nature of the investments could hardly have been more plain.

VMS at *11. See, also, Acme Propane, Inc. v. Tenexo, Inc., 844 F.2d 1317, 1322 (7th Cir. 1988).

This principle protects against frivolous claims. See, Carr v. CIGNA Securities, Inc., 95 F.3d 544, 547 (7th Cir. 1996)(defendant allegedly told plaintiff "that the limited partnerships were safe, conservative investments"; securities fraud claim dismissed because defendant gave plaintiff "documents that disclosed the riskiness of the investment"). See also Kennedy v. Josephthal & Co., 814 F.2d 798, 805 (1st Cir. 1987

Here, this body need not try to reconstruct, as much as ten years after the fact, whether Mr. Lex orally disclosed the risks of the investments to his clients because it is undisputed that all of the pertinent risks were disclosed in writing in the PPMs and the Subscription Agreements. The investor witnesses that the Division called to testify against Mr. Lex were not deprived of this information. For example, Alice Forsyth, M.D., who testified on behalf of the Division, acknowledged that Mr. Lex always presented her with the PPMs relating to the proposed

investments and gave her a full opportunity to review the written materials. (Forsyth testimony at 1514:2-10.) She testified as follows on this subject:

> Q. ...Mr. Lex always provided you with whatever written material was necessary or related to the various notes; isn't that right?
>
> A. Oh, yes.
>
> Q. And gave you an opportunity to read the material?
>
> A. Oh, yes.

(Forsyth testimony at 1514:3-10.) She further testified that Mr. Lex was always available to answer any questions she might have had about the written materials. (Forsyth testimony at 1518:11-14.) Dr. Forsyth further testified that Mr. Lex always presented the McGinn Smith private placements as just one possible investment along with other alternatives, including variable annuities. (Forsyth testimony at 1495:16-1496:25.) And he left it completely up to Dr. Forsyth to decide which investments to make, if any:

> Q. [H]e left it up to you, did he not, for you to study these things and to make your own determination; isn't that right?
>
> A. Yes. We were free to choose.

(Forsyth testimony at 1497:2-6.)

The problem was not that Mr. Lex failed to provide her with all pertinent information regarding the investments, but rather that Dr. Forsyth, by her own admission, never paid attention to the information. She testified that early on she didn't review the materials because she was distracted, and later on she didn't review them because she knew her earlier McGinn Smith investments had been performing well. Her testimony was as follows:

> Q. Did he give you any written materials to review relating to the investment?

A. Yes, he usually gave us written materials to review, and at that time--in 2003, I was still, you know...I was trying to get some other things done.
So I didn't pay much attention to them. I figured that most of the things, these investments, came with papers attached, and **I didn't review them**, though.

* * *

Q. And I assume that before you signed the subscription agreements, you at least read the language that you were signing, right?

A. I **probably** did. **But mostly I didn't examine it closely** because I knew that the early McGinn investments had performed okay....

So I saw no reason to examine them closely.

(Forsyth testimony at 1479:13-24; 1514:11-22; emphasis added.)

Similarly, Dr. Marvin Weinar, who testified on behalf of the Division, acknowledged that before he made investments Mr. Lex would meet with him, discuss the products, and give him the PPMs for him to review. (Weinar testimony at 747:15-24.) Mr. Lex explained the features of the investments, explained the three tranches, and offered only the two most secure tranches. (Weinar testimony at 758:8-759:5; 759:6-9, 19-25; 760:2-4; 762:15-763:17; 768:20-769:6.) Mr. Lex was always available and responsive to Dr. Weinar's questions. (Weinar testimony at 768:17-19; 777:17-20.)

As with Dr. Forsyth, Dr. Weinar candidly admitted that the problem was not a failure to receive the written disclosures of all of the pertinent risks, but rather his own failure to pay attention. Dr. Weinar testified that he only "skimmed [the PPM] and, sad to say, did not read it with the attention I should have." (Weinar testimony at 770:2-4.) Although he signed the Subscription Agreements and knew he was bound by what he signed, he only read the Subscription Agreements "to some extent." (Weinar testimony at 763:18-764:10.) He only

"looked...over" the Subscription Agreements before signing them, even though he knew he would be bound by their terms. (Weinar testimony at 766:20-767:3.)

As set forth above, the court in Carr, supra, warned about the prospect of frivolous claims and faulty memories if investors were permitted to testify about alleged oral representations or omissions contrary to written disclosures in the offering materials. That observation is particularly apt in this case. For example, in testifying in 2014, the Division relies on Dr. Forsyth's recollection that, in December 2004, Mr. Lex allegedly told her that the risk of the TAIN investment was negligible. (Division's FOF 386.) But Dr. Forsyth candidly acknowledged that she had virtually no recollection of her discussion with Mr. Lex regarding that 2004 investment **or any of her other McGinn Smith investments.** (See Forsyth testimony at 1483:15-19, emphasis added.) As Dr. Forsyth was asked about each transaction with Mr. Lex, she made clear she had no recollection of the discussions surrounding any of them.

Mr. Stoelting asked Dr. Forsyth whether she remembered Mr. Lex making certain statements about risk in connection with her second TAIN investment and she responded that she did not remember. (Forsyth testimony at 1480:20-1481:2.)

This was also true of Dr. Forsyth's recollection with the remainder of her investments, that is, she had no specific recollection of conversations regarding any other of these sales. (Forsyth testimony at 1482:10-1487:18.

It was completely improper for Judge Murray to rely on this type of testimony, to subject Mr. Lex to substantial monetary fines, penalties and forfeitures, debarment and public obliquy and censure based on an alleged statement about "negligible risk" nearly 10 years after it was supposedly made, especially where the investor's recollection of the events from that time is admittedly hazy at best, and more precisely, non-existent. And this is not criticism of Dr.

Forsyth. This is one of the salutary rationales for holding the terms of written disclosures to be binding and conclusive, regardless of whether the investors admit that they read them, and barring investors from claiming that the broker made statements or omissions contrary to those written disclosures. Even if the witnesses are earnestly trying to recollect distant discussions to the best of their ability, it is understandable that their memories would be imperfect. It is also an important reason for respecting statute of limitations.

What investors now claim to remember as statements about the "safety" of the Four Funds in general could easily in fact have been explanations about the **relative** safety of the Senior and Senior Subordinated tranches in comparison to the Junior tranche. And it is particularly hazardous to rely on human memory of what was allegedly **not** said many years ago, as the Division does when it relies on Lex's alleged **failure** to disclose the high risks of the investments.

For the foregoing reasons, materiality is lacking as a matter of law.

C. Even if Mr. Lex had characterized the Private Placements as "safe," that is not the sort of measureable, objective assertion of fact that can form the basis of liability for alleged misrepresentations of fact.

According to Judge Murray, Lex's affirmative misrepresentation was that he told the three witnesses the private placements at issue were "safe." Lex denies he so characterized the investments (N.T. 4882:2-8), and the Commission should not base the kind of penalties imposed in this case on 7-9 year-old "statements" by witnesses who are just as likely to be testifying about their impressions or "beliefs" as opposed to actual statements. This dispute of credibility need not be resolved because, as a matter of law, the characterization of a security as "safe" is not the sort of objective, verifiable factual assertion that can give rise to an action for securities fraud.

"To be actionable [as securities fraud], a misrepresentation must be 'one of existing **fact**, and not merely an expression of opinion, expectation, or declaration of intention.'" In re Moody's Corporation Securities Litigation, 599 F.Supp.2d 493, 507 (S.D.N.Y. 2009)(emphasis added)(quoting Greenberg v. Chrust, 282 F.Supp.2d 112, 121 (S.D.N.Y. 2003); Smith v. Meyers, 130 B.R. 416, 423 (Bankr. S.D.N.Y. 1991); In re Duane Reade Inc. Securities Litigation, 2003 WL 22801416 at *4 (S.D.N.Y. 2003)). "To allege a misrepresentation or omission of material fact [under the securities laws], a plaintiff 'must point to a **factual** statement or omission--that is, one that is demonstrable as being true or false." Carlucci v. Han, 886 F.Supp.2d 497, 517 (E.D. Va. 2012)(emphasis in original)(quoting Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 342-43 (4th Cir. 2003); Longman v. Food Lion, Inc., 197 F.3d 675, 682 (4th Cir. 1999)).

"Statements of 'hope, opinion, or belief about...future performance' are not actionable." In re Moody's, supra, 599 F.Supp.2d at 507 (quoting San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 811 (2nd Cir. 1996); Lapin v. Goldman Sachs Group, Inc., 506 F.Supp.2d 221, 239 (S.D.N.Y. 2006)). Similarly, "generalized statements of optimism that are not capable of objective verification are not actionable" under the securities laws. In re XM Satellite Radio Holdings Securities Litigation, 479 F.Supp.2d 165, 176 (D.D.C. 2007). Accord, Grossman v. Novell, Inc., 120 F.3d 1112, 1119 (10th Cr. 1997); In re Harman International Industries, Inc., 2014 WL 197919 at *16 (D.D.C. 2014).

It follows that statements as to the general "riskiness" or "safety" of particular securities are too general to be actionable. Plumbers' Union Local No. 12 Pension Fund

v. Swiss Reinsurance Company, 753 F.Supp.2d 166, 182 (S.D.N.Y. 2010). "[S]tatements that the stock of defendant Monterey was a red hot stock and plaintiff could not lose on an investment in Monterey, that plaintiff would make a bundle of money on the stock of defendant Automated, and that it was impossible to lose money in an investment in Automated...are not actionable under either the federal or state securities laws." Rotstein v. Reynolds & Co., 359 F.Supp. 109, 113 (N.D. Ill. 1973). See also San Leandro, supra, 75 F.3d at 811, Dafofin Holdings S.A. v. Hotelworks.com, Inc., 2001 WL 940632 at *4 n. 6 (S.D. N.Y. 2001), Nanopierce Technologies, Inc. v. Southridge Capital Management LLC, 2003 WL 21507294 at *8 (S.D.N.Y. 2003), and In re Splash Technology Holdings Inc. Securities Litigation, 160 F.Supp.2d 1059, 1077 (N.D. Cal. 2001). Here, "safe" is a relative and subjective matter of opinion, not subject to verifiable proof as either true or false. For this reason, the allegation that an investment was characterized as "safe" cannot give rise to liability for securities fraud.

D. Even if Mr. Lex had failed to orally disclose the risks of the private placements, those omissions cannot give rise to liability because it is undisputed that those disclosures were repeatedly made in writing in the PPMs and Subscription Agreements.

According to Judge Murray, Lex "never mentioned the high risk nature of the notes...." (Division's Brief at 27.) This basis for liability fails as a matter of law because it is undisputed that all investors were repeatedly and specifically warned of the risks in the investments through the numerous disclosures in the PPMs and Subscription Agreements.

The concept of a false affirmative representation is fairly straightforward. But an **omission** is "false" only if "the omitted fact renders a public statement misleading." Carlucci v. Han, 886 F.Supp.2d 497, 517-518 (E.D. Va. 2012); Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 343 (4th Cir. 2003). Accord, Nagel v. First of Michigan Corp., 784 F.Supp. 429,

435 (W.D. Mich. 1991). The anti-fraud provisions do not require a dealer or broker "to state every fact about stock offered that a prospective purchaser might like to know or that might, if known, tend to influence his decision." Trussell v. United Underwriters, Ltd., 228 F.Supp. 757, 762 (D.Colo. 1964). "Liability may exist under Rule 10b-5 for misleading or untrue statement, but not for statements that are simply incomplete." Winer Family Trust, 503 F.3d 319, 330 (3rd Cir. 2007); In re Harman International Industries, Inc. Securities Litigation, 2014 WL 197919 at *19 (D.D.C. 2014). Accord, Brody v. Transitional Hospitals Corp., 280 F.3d 997, 1006 (9th Cir. 2002); Backman v. Polaroid Corp., 910 F.2d 10, 16 (1st Cir. 1990).

This is clear from the wording of the anti-fraud provisions themselves. The misrepresentation provision of Section 17(a) of the Securities Act makes it unlawful:

> to obtain money or property by means of any untrue statement of a material fact or any **omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.**

15 U.S.C. § 77q(a)(2)(emphasis added).

In substantively identical language, the misrepresentation provision of Rule 10b-5 makes it unlawful:

> To make any untrue statement of a material fact **or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.**

17 C.F.R. § 240.10b-5(b)(emphasis added).

Here, Mr. Lex was not required to orally advise his clients of the risks of the investments because those risks were thoroughly and repeatedly spelled out in writing in the PPMs and the Subscription Agreements. In connection with the purchase of the Notes in question, all of Mr.

Lex's customers signed a Subscription Agreement informing them of the detailed risks. (See Division Exhibit 5 at 36-38; and Division Exhibit 5 at 1, 9, 11-13.)

Mr. Lex's clients were already informed that there was no guarantee of liquidity, that cash flow depended in finding suitable investments, and that they could lose their entire investment. To the extent liquidity problems eventually occurred with the onset of the world-wide financial crisis, no additional oral disclosures were required to "correct" the prior written representations because the original written disclosures already fully advised the investors of that very risk, as well as all other pertinent risks.

E. There Were No Red Flags That Required Investigation By Lex

As part of her rationale, Judge Murray states:

> "Without resolving the red flags that he learned about on January 8, 2008, Lex recommended and sold MS&Co private placements: FAIN, TDM Cable and INEX to Forsythe, Monahan and Weinar after January 8, 2008, and he did not disclose his material information to his clients." [I.D. p. 103]

There are several problems with this conclusion, both factual and legal. Initially, we point out that on page 34 of the Initial Decision, Judge Murray found that "Lex was not invited to the meeting of registered representatives on January 8, 2008, and no one called and told him what transpired at the meeting. (N.T. 4895-97)." This was an appropriate finding in light of the fact that there was no testimony that Mr. Lex was present, and because the reduction in interest in the Four Funds notes only pertained to the junior tranche and Mr. Lex only sold senior and senior subordinated. Lex eventually heard about the interest reduction, but did not hear any of the details of Smith's presentation, not being present. On hearing of the interest reduction, Mr. Lex reasonably would have concluded that this was not evidence of "fraud" or, as Judge Murray states, "mismanagement," but actually a reasonable action for a fund manager to take (a

reduction of interest in one tranche) especially in light of the serious adverse conditions in the economy at the time, to protect the more secure tranches which were going to continue to be paid regular interest. To suggest that the reduction in interest in a junior tranche only is a red flag for fraud is an unreasonable inference for the ALJ to draw.

As stated in South Cherry Street, LLC v. Hennessee Group, LLC, 573 F.3d 98 (2009) cited by Judge Murray as establishing the legal standard for reckless conduct:

> " . . . An inference of scienter must be more than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent."

Here, the ALJ, without any justification, chose the inference consistent with scienter even though the innocent inference was equally, if not more, compelling and reasonable.

Finally, The Administrative Law Judge erred in finding that the January 8, 2008 notice of reduction in interest in the Four Funds' junior Notes constituted a red flag, even as to the Four Funds' junior Notes, because the possibility of such a restructuring was specifically disclosed and authorized in the Private Placement Memorandum, particularly in the event of an economic downturn. (See, e.g., Division Exhibit 5 at 13 & 14 [pages 7 & 8 of PPM].) McGinn Smith's rationale for the reduction in interest, to protect the Senior and Senior Subordinated Notes in the face of the severe, worldwide financial crisis, where Mr. Lex's clients all held Senior or Senior Subordinated Notes, did not give any indication of fraud or mismanagement, but appeared reasonable.

1. Transactions with affiliates

The ALJ apparently agrees with the proposition advanced by the Division that the possibility of transactions with affiliated entities is a red flag, but again, this feature of the Four Funds was fully disclosed in the PPMs. See, *e.g.,* Division Exhibit 5, PPM for FIIN at 7.

Because this feature of the investments is common and was fully disclosed in writing, it was not a red flag or cause for heightened investigation. Nevertheless, the ALJ apparently maintains that "Selling Respondents should have asked for information on all affiliated transactions and demanded to know whether the price restrictions were observed." To demand verification of whether the price restrictions on transactions with affiliates were observed, would impose an impossible burden on each of the more than 40 individual brokers, that no Rule, Notice, case or other legal authority requires. As a practical matter it would require access to, and analysis of, untold reams of banking and financial records, and would unnecessarily duplicate the work that investment bankers, accounting departments, and outside accountants are charged with performing. For purposes of efficiency, the detective work that the ALJ now imposes on individual brokers, is already allocated to those with the expertise and resources to perform it, such as investment bankers, accountants and compliance personnel inside the broker-dealer.

Kerri Palen was able to unearth such information only with training as a CPA and certified fraud examiner, subpoena power, access to 400 separate bank accounts, accountants' work papers, all of the confidential tax records and financial statements of McGinn Smith and its affiliates and principals at her disposal, three years of work, and all of the resources of the SEC behind her. (Division Exhibit 1, Palen Declaration ¶¶2, 6-9; Palen testimony at 231:17-20; 404:16-17; 509:16-25.)

While Palen conducted her investigation once, after McGinn Smith had been shut down by the SEC, under the ALJ's finding the brokers would have had to be conducting their investigation continuously throughout 2003-2009 as the Four Funds and the Trusts continued to

make their investments. The law does not require brokers to duplicate the job of the broker-dealer and its team of professionals.

Before selling any private placement investment to an unaccredited client, Mr. Lex always checked first with Patricia Sicluna, the vice president of registration, to make sure that that offering had not exceeded the limit of 35 unaccredited investors. (N.T. 1618:2-17.) Patricia Sicluna kept running track of whether the number of non-accredited investors for any particular offering exceeded the limit of 35 allowed under Regulation D. For example, by e-mail dated February 21, 2006, Ms. Sicluna informed Richard Feldmann as follows: "We have room for non-accredit[ed] investors" in FAIN. (Lex Exhibit 137.) The ALJ appeared to need corroboration of Lex's testimony that he regularly called Patricia Sicluna to find out the status of unaccredited investors. The Division, which had access by subpoena during its civil case against McGinn and Smith, never presented Ms. Sicluna to contradict this testimony. The above-mentioned e-mail corroborates that she was keeping track and that she was advising brokers of the count.

2. Confidentiality

Lex kept up with the status of the Four Funds in regular, constant conversations and communications with Smith about their performance. (N.T. 4881:17-23.) In response to Lex's requests, Smith informed Lex what industry sectors the Four Funds were invested in, but initially explained that confidentiality agreements prevented him from disclosing the names of individual companies in which the Four Funds were invested. (N.T. 4884:21-4885:12; 4887:7-24; Lex Exhibit 25, letter dated March 22, 2006 from McGinn Smith to Mr. Lex listing the investment portfolio of FIIN, FEIN and TAIN by industry and percentage allocation.)

Smith's explanation about confidentiality agreements seemed reasonable to Lex because, based on their relationship of more than two decades at that time, Lex had every reason to trust Smith. (N.T. 4885:13-19.) As Charles Bennett explained, there is nothing suspicious or unusual about small companies requesting confidentiality for their loan or investment agreements. (Bennett testimony at 4153:11-4154:13.)

Mr. Bennett's expertise in this regard should carry significant weight because he has served as a senior capital markets executive and corporate securities lawyer with over 30 years' experience in all aspects of public, private and municipal underwritings and distributions in both governmental and private sectors. (Lex Exhibit 147, Bennett CV at 1; Bennett testimony at 4029:15-4031:8.) He was chief compliance officer and in-house counsel responsible for developing, implementing, and overseeing sales practices and compliance systems for broker-dealers and investment advisors, and he consulted with broker-dealers and investment advisors to assure compliance with applicable legal and regulatory mandates. (Lex Exhibit 147 at 1.)
Mr. Lex continued to ask Smith and McGinn Smith CFO David Rees for updates on the Four Funds' investments. (N.T. 4887:25-4889:25; Lex Exhibits 39, 40 & 78, e-mails of 8/1/07 & 8/8/07.) In response to Lex's requests, on August 9, 2007 he received written portfolio analyses of the Four Funds' investments, showing the identity of the companies, a description of the investment, the amount of principal invested, and the yields. (N.T. 4890:2-5; Lex Exhibits 63 & 125.)

After Mr. Lex received the portfolio analyses he had a follow-up discussion with McGinn Smith CFO David Rees in which Mr. Reese informed Lex and that all of the investments were performing and that there were no defaults or problems with the investments. (4890:6-16.)

By e-mail of August 15, 2007, Mr. Lex (through his assistant, Deb Adkins) wrote to David Rees as follows:

> Thank you for your listing of the assets in each of the Note Offerings. **I am confirming our recent conversations that all of the assets in the notes are performing and there are no pending or suspected defaults.** Thanks again for your help. **I would hope to be advised if any problems develop.**

(N.T. 4890:17-23; Lex Exhibit 41, emphasis added.)

There was no unusual or suspicious "secrecy" about the Four Funds investments.

3. <u>The August 2007 Portfolio Analysis</u>

As set forth above, in August 2007, Lex received, in response to his requests, a portfolio analysis of the Four Funds' investments, showing the identity of the companies, a description of the investments, the amount of principal invested, and the yields. (N.T. 4890:2-5; Lex Exhibit 63 & 125.) According to Judge Murray, this document was a red flag (see heading XI(C)(4) in Division's FOF page 76, stating: "The August 2007 Portfolio Analysis Received by Lex Was a Red Flag"), which required Lex to perform "due diligence on the Trust Offerings in 2008 and 2009." (Division's FOF 348.)

Judge Murray finds that the August 2007 portfolio analysis reflects overlapping investments among the Four Funds, and David Smith had initially told Lex that the Four Funds would not have overlapping investments (Division's FOF 347), and therefore a "red flag."

The first and most critical problem with this argument is that **the OIP does not characterize the August 2007 portfolio analysis as a red flag.** Indeed, the OIP does not even mention the 2007 portfolio analysis at all. In response to the concern raised in Respondents' pre-trial Motions for a More Definite Statement, the Division assured the Respondents and Judge

Murray that the recitation of red flags in the OIP was intended to be exclusive. The Division stated:

> [Respondents] complain that they are uncertain whether there are red flags other than the ones identified in the OIP. The OIP, however, should not be read to suggest that there is some category of unnamed and undisclosed red flags. **The red flags discussed in the OIP are the red flags that will be presented at trial….**

(Division's Memorandum of Law in Opposition to Motions for More Definite Statement, filed Nov. 25, 2013, at 7; emphasis added.) The August 2007 portfolio, therefore, cannot be offered as a red flag.

At trial, when the Division sought to present testimony of an alleged red flag that was not listed in the OIP, Russell Ryan, on behalf of Mr. Lex, reminded the Judge about the Division's pre-trial representation that the list of red flags in the OIP was exclusive, and the Judge properly agreed. N.T. 271:5-272:15.)

On the merits, contrary to the Division's assumption, there is no basis for concluding from the August 2007 portfolio analysis that Smith's pre-2007 statement was a "lie." It is equally plausible that the common investments reflected a change in strategy.

Lex testified that he was disappointed when he learned in August 2007 of the overlapping investments, not because Smith had "lied" to him earlier, but rather because Smith had failed to keep Lex up to date and notify Lex that his strategy had changed after Smith first indicated that he planned different investments for each of the Four Funds. (Lex testimony at 4954:6-4958:6.)

Lex did specifically inquire and follow up with Smith about the change in strategy. In response, Smith "assured [Lex] that as the manager, he was doing those assets in multiple LLCs because they were performing, and he thought if it benefits FIIN, it will benefit

another one." (Lex testimony at 4958:2-6.) The explanation that the Four Funds were performing, and that Smith's strategy was working, conformed with Lex's experience in seeing his clients at that time continuing to receive all of their interest payments and redemptions on time and in full. (N.T. 4890:24-4891:13.)

Because the PPMs did not prohibit common investments among the Four Funds, and because all investors affirmed in writing that they were not relying on representations outside the PPM, any oral statement about a plan to avoid common investments was immaterial as a matter of law. Acme Propane, Inc. v. Tenexco, Inc., 844 F.2d 1317, 1322 (7th Cir. 1988); Taylor v. Prudential Insurance Company of America, 2003 WL 21314254 at *7 (S.D. Ind. 2003); Wamser v. J.E. Liss, Inc., 838 F.Supp. 393, 397 (E.D. Wisc. 1993); In the Matter of VMS Limited Parnership Securities Litigation, 1992 WL 249594 at *11 (N.D. Ill. 1992).

4. January 2008 default of the Four Funds Junior Notes

According to Judge Murray, the announcement in January 2008 of the default of the Four Funds Junior Notes should have been a red flag to the Respondents about all tranches of the Four Funds and, indeed, all McGinn Smith private placements. (I.D. p. 103.) The Division refers to a meeting on January 8, 2008 in Albany at which McGinn allegedly told the attendees that they needed to "pump out the swamp" and drive up revenues to generate fees for McGinn Smith. (Division's FOF 162.)

It is undisputed that Mr. Lex was not invited to, and did not attend, the January 8, 2008 meeting (N.T. 4895:9-15), and Judge Murray so found. (I.D. p. 34). He was not aware of the meeting, and no one told him what occurred at the meeting. (N.T. 4896:18-4897:2.)

On January 14, 2008, a draft letter intended for Junior noteholders in the Four Funds was distributed by e-mail to certain McGinn Smith brokers for their review. (Division

Exhibit 151.) The letter stated that, because of the financial crisis, McGinn Smith Advisors was taking proactive measures to protect the LLCs by reducing the interest payments to Junior noteholders only to 5%. (Division Exhibit 151.)

Mr. Lex was not listed as a recipient of the January 14, 2008 e-mail distributing the draft letter referred to above, and he did not receive the draft letter referred to above. (N.T. 4896:11-17; Division Exhibit 151.)

Although he eventually learned about the reduction in interest payments on the Junior Notes, that did not affect any of his clients precisely because he had no clients with Junior Notes. If anything, the restructuring affirmed Lex's foresight in restricting his sales to the most secure tranches, Senior and Senior Subordinated.

The Division next refers to more restructuring in April 2008. (Division's Brief at 24.) But because all of Mr. Lex's clients were in the Senior-most Notes, all of Mr. Lex's Four Funds clients continued to receive their interest payments for an additional two years, through April 2010, when the SEC shut down McGinn Smith. (N.T. 4917:23-4918:6.) In October 2008, all tranches were affected by a payment restructuring, except for interest to the Senior-most Notes. (See Division Exhibit 192.)

Mr. Lex's expert witness, Charles Bennett, explained that the restructuring of the Four Funds was not a red flag as to the Trust Offerings because the Trusts "were totally separate and segregated offerings." (N.T. 4074:6-7.) The Division's own expert acknowledged that the Trust Offerings "were not at all similar to the income notes…." (Division Exhibit 1, Lowry expert report at 25.) Indeed, the OIP itself states that the Four Funds were "far different" from the Alarm Trusts. (OIP ¶38b.)

Furthermore, as of the time Bill Lex started selling Trusts again (March 2006, see page 13 of Exhibit 4k of Division Exhibit 2), the only experience he had had with the Trusts was their exceptional performance.[1]

5. The Trust Offerings

The Division states that with the Trust Offerings, "McGinn and Smith's fraudulent uses of offering proceeds became even more flagrant," and that they engaged in "outright theft and other improper uses of offering proceeds." (Division's Brief at 24, 25.) But there is no evidence that Mr. Lex knew or should have known of the carefully concealed fraud and theft.

The Division also claims that two "red flags" are found on the face of the Trust PPMs: fees that the Division now characterizes as "exorbitant" and provision for use of Trust proceeds to redeem earlier Trust investors. (Division's Brief at 25.)

The only Trust with unusually high fees on its face was Benchmark, and the Division's own evidence reflects that **Mr. Lex never sold any Benchmark.** (See Exhibit 4k to Division Exhibit 2, summary of Lex sales.)[2] The redemption of earlier Trusts, if connected with asset acquisition, cannot be viewed as a red flag.

F. The ALJ Was Not Independent of the Prosecutorial Arm of the Commission and Lacked Independence, Violating Lex's Right to Due Process

The Administrative Law Judge demonstrated a lack of judicial independence and commingling of judicial and prosecutorial functions in her handling of Lex's Motion for

[1] Of course in hindsight, the Division says there were problems with the alarm notes that were "covered up" by the 2003 IASG public offering. But there is no evidence that Lex was aware of any of that when he was selling the post-2006 Trusts.

[2] The Division's case arises from the sale of 26 offerings. (See Division Exhibit 2, Palen Declaration¶4 and Exhibit 3 thereto.) The Division's own evidence reveals that Lex never sold any investments in three of the offerings on that list: TDM Luxury Cruise Trust, Cruise Charter Ventures Trust, and TDMM Benchmark Trust. (See Exhibit 4k to Division Exhibit 2, summary of Lex sales.)

Summary Disposition and Motion for Leave to File the Motion for Summary Disposition. For the reasons set forth in the Joint Brief, Lex was entitled to summary or partial disposition in his favor under 28 U.S.C. § 2462 because the proceeding was commenced more than five years after the claim first accrued. The Administrative Law Judge nevertheless refused to even consider the merits of Lex's Motion for Summary Disposition, reasoning that Mr. Lex's Motion differed from the obvious position of the Commission. The Judge therefore denied Lex's Motion for Leave to File Motion for Summary Disposition, and in a telephone conference on the issue the Judge explained as follows:

> My belief is that when the Commission sets a case down for hearing, and there has been no factual changes between when they made the decision to set it down and when the motion for summary disposition has been filed, that **the agency does not want motions of summary disposition granted because you're second-guessing their decision that the case needs to get set down for hearing and that there is a legal basis for it**....I work for the Federal Government. I am an Administrative Law Judge. The case is in this office. **It's been assigned to me for decision. So I have to hear it.**

(N.T. of 1/21/14 pre-hearing telephone conference at pages 30, 33-34)(emphasis added). This demonstrated that the Judge was not independent and in a position to rule on matters before her, but was bound by the Commission's prosecutorial arm, thus violating Mr. Lex's due-process right to a fair hearing before an independent tribunal.

G. The Customers Are Bound To Know of the Warnings Which They Received in the PPM and Which They Acknowledged in the Subscription Agreement. It is No Excuse That They Did Not Read Them or Pay Attention

The Administrative Law Judge erred in discounting the warnings and risks disclosed to customers in the Private Placement Memoranda on grounds that the customers allegedly "did not

study them [the PPMs] in detail." (I.D. p. 91.) As a matter of law, customers are imputed with notice of disclosures they receive in writing in the PPMs, regardless of whether, or how thoroughly, they read them. Brown v. The E.F. Hutton Group, Inc., 991 F.2d 1020 (2nd Cir. 1993); Carr v. CIGNA Securities, Inc., 95 F.3d 544, 547 (7th Cir. 1996); Wamser v. J.E. Liss, Inc., 838 F.Supp. 393, 399 (E.D. Wisc. 1993).

H. The September 3, 2009 Disclosure Is Irrelevant As To Lex Because He Sold No Securities After That Date

The Administrative Law Judge's finding that the September 3, 2009 disclosure of the Firstline bankruptcy filing constituted a red flag (Initial Decision at 93) is irrelevant as to Mr. Lex, because Mr. Lex sold no securities after September 3, 2009. (See Exhibit 4k to Division Exhibit 2, Summary of Lex Sales). In fact, Lex's last sale of a McGinn Smith private placement---a Trust Offering--was July 17, 2009. (Id.) Because Mr. Lex made no sales after that date, he could not be liable for having failed to impart that information to customers in connection with sales.

I. The ALJ Erred in Connecting the Four Funds Red Flags to the Trusts

The Administrative Law Judge erred in finding that alleged red flags with respect to the Four Funds provided a basis to impose a duty on Lex to investigate the Trust Offerings, or that selling the Trusts without disclosing the Four Funds "red flags" was Securities Fraud. As the Division conceded (OIP ¶38b), the Trust Offerings were entirely different investments from the Four Funds. Unlike the Four Funds, the Trust Offerings were not blind pools. The Trust Offerings were collateralized by specific receivables, whereas the Four Funds were Notes

initially dependent on unknown investments. The Trust Offerings investments were selected by Timothy McGinn, who had substantial successful experience in alarm and triple play offerings. The Trust Offerings' investments were vetted by the McGinn Smith due diligence team. All of this gave the brokers confidence in the Trusts, independent of what may have happened with the Four Funds. Furthermore, the Administrative Law Judge erred in concluding that evidence of cash flow problems in the Four Funds should have alerted brokers to problems in the alarm Notes (Trusts), or to suspect every new investment proposal affiliated with McGinn Smith. This error was particularly prejudicial because all of Mr. Lex's sales of the Four Funds were before September 23, 2008, and therefore outside the statutory (5-year) period. With no evidence of red flags pertaining to the Trust Offerings themselves that Lex sold, the Judge improperly imposed liability for sales of the Trust Offerings based on alleged red flags that: (a) pertained to entirely different investments, and (b) were outside the statutory (5-year) period. Furthermore, it was error to impose a duty to investigate the Trusts, when the purported red flags all related to the Four Funds.

J. <u>Section 5 Requires Scienter</u>

The Administrative Law Judge erred in holding that a violation of Section 5 of the Securities Act does not require scienter where Regulation D provides an exemption to the registration requirement if there are, or the issuer **"reasonably believes"** there are, no more than 35 unaccredited investors. 17 C.F.R. § 230.506. Because broker liability under this section has only been established by extension, the broker is entitled to the same standard as the issuer. The Administrative Law Judge erred in holding that Respondent Lex willfully violated Section 5 of the Securities Act where the undisputed testimony was that Mr. Lex reasonably relied on the

operations manager at McGinn Smith who was charged with keeping a running total of the number of unaccredited investors for each offering, to ensure that it did not exceed the maximum number of 35, thus qualifying for the registration exemption set forth in Regulation D/SEC Rule 506.

K. It Was Reasonable For Lex to Rely on the Broker-Dealer for Product Due Diligence

To the extent that the Administrative Law Judge held that individual brokers had a duty to investigate proposed investment products, the Judge erred in finding that Mr. Lex breached that duty in this case, where the evidence established that he familiarized himself with the PPMs; reviewed them with his clients; reasonably relied on the due diligence performed by the broker-dealer that is specifically charged with the investigatory responsibility, and was particularly equipped and staffed to perform extensive due diligence; reasonably relied on the long-time, successful experience of McGinn Smith private placements; and regularly inquired of David Smith and the CFO of McGinn Smith about the status of the investments in question.

L. If Disgorgement and Penalties Are Upheld, Lex Is Entitled to Credits

The Administrative Law Judge erred in failing to credit Mr. Lex with $511,438.00 that he and his wife invested in Four Funds and Trust Offerings investments that to this day is being sequestered and exempted from any distribution by the McGinn Smith Receiver. (Lex Ex. 153 [summary of Lex family investments per Receiver's website]; Lex Ex. 55 [back-up documentation from the Receiver's web site showing the Lex family investments]; N.T. 4880.) The Administrative Law Judge erred in failing to credit Mr. Lex with $125,000 that he and his

wife contributed to the Firstline rescue plan on April 12, 2010, some five months after he had terminated all association with McGinn Smith (N.T. 4919), and just days before the receivership froze all McGinn Smith assets on April 20, 2010. This was his voluntary contribution to the "rescue plan," and an attempt to save his clients from the losses in the Firstline investment.

M. The ALJ Erred In Her Cease & Desist Order Because There Was No Showing That a Future Violation Was Likely To Occur

The Administrative Law Judge erred in issuing a cease and desist order against Mr. Lex (Initial Decision at 114) because before imposing such an order, "the Commission must establish a sufficient evidentiary predicate to show that such **future** violation may occur." Aaron v. Securities and Exchange Commission, 446 U.S. 680, 701 (1980)(emphasis added), citing SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90, 98-100 (2nd Cir. 1978). Here, there was no such evidentiary predicate because: (a) Mr. Lex had an untarnished record of 40 years in the securities industry and insurance business, with his only blemish coming as a result of a third party's secret fraudulent scheme of which he admittedly had no knowledge; and (b) it was undisputed that Mr. Lex has been out of the securities industry ever since October 2010, and he had, and has, no intention of ever returning to that industry. This is clearly penal in nature since it will likely eliminate his only way of earning a living as well – as an insurance salesman.

N. A Permanent Bar From Association With Licensed Persons Is Unnecessary Because Lex's Conduct Was At Most Negligent, and That Does Not Justify A Permanent Bar

The Administrative Law Judge erred in imposing a permanent bar on Mr. Lex's association with any broker-dealer or investment advisor (Initial Decision at 117) because such a

sanction, with the attendant "loss of livelihood and the stigma attached to permanent exclusion," requires evidence "that **future** misconduct will occur." Securities and Exchange Commission v. Patel, 61 F.3d 137, 141-142 (2nd Cir. 1995)(emphasis added). There was no such evidence in this case. The Administrative Law Judge erred in imposing a permanent bar on Mr. Lex's association with any broker-dealer or investment advisor (Initial Decision at 117) because Lex was not the primary actor, but rather failed to detect a fraud perpetrated by Timothy McGinn, David Smith, who were criminally convicted. In Johnson v. Securities and Exchange Commission, 87 F.3d 484, 490 (D.C. Cir. 1996), the court reversed a **6-month** suspension where Johnson was not the primary actor in the fraud, but merely failed to detect the fraud of another broker **under her supervision**. Here, Mr. Lex was **not** responsible for supervising McGinn or Smith, yet the Judge imposed a **lifetime** suspension. This was clear error.

O. Third-Tier Penalty Was Inappropriate

The Administrative Law Judge erred in imposing a third-tier monetary penalty, the highest level, on Mr. Lex (I.D. pp. 115-116, 118) because: (1) the Judge acknowledged that only conduct occurring on or after September 23, 2008 could be considered in assessing the penalty (Initial Decision at 116); (2) the only evidence against Mr. Lex consisted of failure to conduct a sufficient investigation, as opposed to actual fraud or deceit; and (3) there is no need for deterrence because Mr. Lex has been out of the securities industry since 2010. (See I.D. p. 116, acknowledging that scienter and need for deterrence are relevant factors in assessing monetary penalty).

P. Without Red Flags Related to Trusts, It Was Inappropriate for the ALJ to Impose Disgorgement For Post-September 23, 2008 Sales

The Administrative Law Judge erred in ordering disgorgement because the only "red flags" that the Judge found related to the Four Funds, and Lex did not sell any Four Funds within the statutory period, i.e., after September 23, 2008. Lex's only sales after September 23, 2008 were of Trust Offerings. Because there were no red flags as to the Trust Offerings, Lex had no ill-gotten gains from sales after September 23, 2008 that could be subject to disgorgement. The Administrative Law Judge erred in ordering disgorgement of $169,375 (I.D. p. 117, as modified by April 9, 2015 Order on Motion to Correct Manifest Errors of Fact) because the order: (1) improperly included commissions earned on sales before September 23, 2008; and (2) constituted gross figures, from which Mr. Lex paid approximately 25% for expenses in office supplies and equipment, utilities, rent, telephones, computers, clerical help, and so on. (N.T. 4867:9-22; 4868:3-5; 4868:22-4869:4; 1583:11-14.)

Q. Lex Was Entitled To A Jury Trial And the Presumption of the Rule of Lenity In Interpretation of These Penal Securities Statutes

The case was penal and punitive in nature, in light of the claims of fraud and the requests for enhanced monetary penalties, the cease-and-desist order, and the lifetime suspension order. Accordingly, Respondent Lex was deprived of his right to:

(a) have his case decided by a jury (Article III, Sec. 2, ¶3); and

(b) before an Article III Court have the Rule of Lenity applied, requiring all statutory ambiguities to be resolved in Respondent Lex's favor.

R. The Commission Pre-Judged The Case, Thus Depriving Lex of Due Process of Law

Mr. Lex's due process right to a fair hearing and an impartial adjudicator was violated because the Commission prejudged the case against the brokers as evidenced by, *inter alia,* the following: (a) the Commission's Complaint, Motions and Briefs filed in SEC v. McGinn, Smith & Co., et al., N.D. N.Y. No. 10-CIV-457; (b) the Commission's press release issued in connection with the filing of the OIP in the instant enforcement proceeding; and (c) the Commission's Findings of Fact and Conclusions of Law filed in connection with the case against Respondent Richard D. Feldmann in the instant enforcement proceeding. The above-described documents reflect that, even before the Administrative Law Judge reached her decision in this case, the Commission had already prejudged many of the issues underlying this case in a manner adverse to the brokers, including Mr. Lex.

S. Incorporation By Reference

Respondent Lex incorporates by reference the claims, and assertions of error raised by the other Respondents in this case regarding the process, the findings and conclusions, the penalties, and any other issues applicable to all Respondents.

CONCLUSION

Based on the foregoing, Respondent Lex respectfully requests that the Commission reverse the Decision and dismiss the proceedings, with prejudice.

Respectfully submitted,

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DATE: July 17, 2014