UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15514

RECEIVED
OCT 01 2015
OFFICE OF THE SECRETARY

In the Matter of

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

Respondents.

DIVISION OF ENFORCEMENT'S BRIEF IN RESPONSE TO RESPONDENTS' INDIVIDUAL BRIEFS

Respectfully submitted,

DIVISION OF ENFORCEMENT
David Stoelting
Haimavathi V. Marlier
Michael D. Birnbaum
Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281
(212) 336-0174 (Stoelting)
(212) 336-1055 (Marlier)
(212) 336-0523 (Birnbaum)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES **PAGE**

STATUTES AND RULES

PRELIMINARY STATEMENT

The fraudulent scheme that led to the downfall of broker-dealer McGinn Smith & Co., Inc. ("MS & Co.") and caused nearly 900 investors to lose approximately $80 million would not have been possible without top-performing in-house salesmen Frank Chiappone, William Lex, Thomas Livingston, Brian Mayer, and Philip Rabinovich ("Selling Respondents") and supervisor Andrew Guzzetti (collectively, "Respondents"). The evidence presented at a hearing before Chief ALJ Brenda Murray supported an Initial Decision ("ID") finding (i) Selling Respondents liable for fraudulent sales of unregistered securities warranting disgorgement, industry bars/suspensions, third-tier civil penalties, and cease and desist orders, and (ii) Guzzetti liable for failing to supervise MS & Co. brokers, warranting an industry suspension and third-tier civil penalty.

In addition to attacking the ALJ's findings and authority to even hear this matter in a joint brief (addressed in the Division's Response to Respondents' Joint Brief ("Div. Jt. Resp.")), Respondents each submitted individual briefs arguing that they, personally, did nothing wrong. This submission opposes those arguments with the factual record, including Respondents' own sworn testimony, and in doing so makes clear that Respondents should be liable for their egregious violations of the securities laws and face meaningful sanctions. Selling Respondents put their livelihoods before their duties to their customers when they (i) recommended and sold millions of dollars of unregistered MS & Co. private placements in the face of obvious red flags of increasing number and intensity, and (ii) made material misrepresentations and omissions in connection with those sales. And Guzzetti failed to discharge his supervisory responsibilities when he repeatedly ignored clear red flags and other indications of wrongdoing, choosing to act as a cheerleader, rather than a supervisor, as brokers under his supervision defrauded scores of investors.

Selling Respondents, for their violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 10b-5 thereunder and Securities Act Sections 5(a) and 5(c), should be barred from the industry, ordered to disgorge their commissions on illegal sales (with prejudgment interest) and pay third-tier civil penalties, and be ordered to cease and desist their violations, and Guzzetti should face a bar and third-tier penalties.

STATEMENT OF FACTS

The Division's charges arise out of Selling Respondents' fraudulent sales of millions of dollars of unregistered MS & Co. private placements: the "Four Funds," "Trust Offerings," and "MSTF"[1] (collectively the "Four Funds and Trusts"), and Guzzetti's failure to supervise them. *See* Initial Decision ("ID") at 5-9 & n.14. Selling Respondents sold millions of dollars of these offerings, earning high commissions for themselves but generating enormous losses for customers. Division Exhibit ("DE") 2 at 48. All Respondents still work in the industry, except Lex, whom FINRA suspended in 2010. DE 482 at 10-13; ID at 113.

I. MS & Co.'s Fraud Began with the Pre-2003 Trusts

Before forming the Four Funds, MS & Co. sold unregistered trust offerings which securitized cash flows from security alarm contracts ("Pre-2003 Trusts"). ID at 4. Although Pre-2003 Trust noteholders were supposed to be paid from alarm contract cash flows, *see, e.g.,*

---

[1] The Division cites to the ID for uncontested background evidence and adopts the ID's abbreviations. Respondents, by contrast, cite directly to their proposed findings of fact, as submitted to the ALJ. *See* Rule of Practice 450(c) ("[t]he number of words shall include pleadings incorporated by reference"). Should the Commission review Respondents' proposed findings of facts, the Division respectfully urges the Commission to review its Proposed Findings of Fact and Conclusions of Law, dated April 9, 2014.

DE 355 at 13, these Trusts were—by Smith's admission—a Ponzi scheme, and a high percentage were paid out with proceeds from the 2003 IPO of IASG, a public company for which McGinn served as CEO. ID at 4; Liv. Ex. 31, 32 at 6; Tr. 2432:7-11. Investors in Pre-2003 Trusts that were not rolled into the IASG IPO were redeemed using proceeds raised from Four Funds investors, and Selling Respondents knew this. DE 2 ¶¶ 25-50; Tr. 1553:12–1554:4, 1921:2-5, 2235:12–2236:5, 2693:7-22, 3265:25–3266:17. Thus, the fraud at MS & Co. did not begin with FIIN in September 2003: as Livingston testified, "this Ponzi scam" began much earlier. Tr. 2315:19 – 2316:25.

II. The Fraudulent Four Funds

MS & Co. raised over $85 million through the Four Funds between 2003 and 2008. ID at 5. The Four Funds were a failure. By year-end 2007, the Four Funds had invested over 50% of their assets in MS & Co. affiliates, including investments in the Pre-2003 Trusts and each other. DE 2 ¶ 52 & 140-41. Most of these investments generated no cash flow, DE 2 ¶ 52, including the Four Funds' $8.8 million investment in alseT, a venture capital startup headed by Livingston that generated no income and needed to borrow money just to make interest payments to the Four Funds. *Id.*; Tr. at 2274:20-21. The Four Funds paid approximately $7.7 million in various fees to MS & Co. and borrowed money from each other to pay investor redemptions and interest. DE 2 ¶¶ 58, 61 & 135-141, 147; DE 584.

By year-end 2007, the Four Funds owed investors approximately $84 million but their assets were worth only approximately $37 million. DE 2 ¶ 59, 140-41.

III. The Fraudulent Trust Offerings and MSTF

Beginning in November 2006, MS & Co. raised $40.9 million from Trust Offerings and MSTF investors. DE 2 ¶¶ 63, 98 & 47, 129; ID at 7-9. Proceeds raised from Trust Offerings were supposed to be invested in specific receivables, usually related to long-term contracts for alarm service, "triple play" (broadband, cable and telephone) service or luxury cruise bookings. DE 2 ¶ 64. Instead, Trust Offering investor funds improperly enriched McGinn, Smith and others personally and funneled money to MS & Co. and its affiliates. DE 2 ¶¶ 66, 76-102 & 131-32.

Moreover, for each Trust Offering, the total proceeds actually invested was less than the amount specified in the PPMs. DE 2 ¶ 66 & 149-51 (58% of Trust proceeds invested versus 85% promised in aggregate).

Certain Trust Offerings charged exorbitant fees. DE 2 at 149-51; DE 1 at 27. For example, while the cover page of the Benchmark PPM promised that 92% of the maximum $3,060,000 raised would be used to acquire assets, the PPM later noted that only $1,950,000 or 65% would be used to acquire assets, leaving 35% for fees. DE 63 at 1, 8. And Benchmark invested even less than what was promised: only 53% of the $1,325,000 raised from investors was actually invested in accordance with the PPM. DE 2 at 151.

MS & Co. also created four Trust Offerings for the express purpose of redeeming investors in maturing trusts: TDM Cable Trust 06, TDM Verifier Trust 07R, TDM Verifier Trust 08R, and TDM Verifier Trust 11. DE 2 ¶ 67.

IV. MS & Co.'s Repeated Net Capital Violations

Beginning in October 2007, National Financial Services, LLC ("NFS") sent Smith frequent letters indicating that MS & Co. risked a net capital violation. DE 643, 645. Smith and McGinn asked Rabinovich, Mayer, and Guzzetti for a capital infusion during the second or third quarter of 2009. Tr. 2125:2-13. NFS terminated its clearing relationship with MS & Co. on September 29, 2009. DE 643 at 15.

V. Respondents Ignored Red Flags Demanding Further Inquiry

From 2003 to 2009, Respondents faced persistent and obvious red flags that should have prompted them to investigate the Four Funds and Trusts before recommending them.

- ***The Pre-2003 Trusts failed.*** Respondents knew, or should have known, that the Pre-2003 Trusts were a failure and had to be rolled up into the IASG IPO. *Supra* at 2-3. This should have prompted questions about the use of Four Funds proceeds and MS & Co.'s purportedly successful track record. *See* Div. Jt. Resp. at 20.

- ***The Four Funds' investment mandate differed entirely from the Pre-2003 Trusts.*** Unlike the Pre-2003 Trusts, which securitized cash flows only from security alarm contracts (ID at 4; Tr. 1915:16-25), the Four Funds had a broad investment mandate which *never* disclosed the precise category of investments the LLCs would make.[2] *See, e.g.,* DE 5 at 7.

- ***Smith had never served as manager for offerings like the Four Funds.*** Before FIIN, Smith never served as manager, and MS & Co. never served as placement agent, for an offering with an investment mandate like the Four Funds, which gave Smith unfettered investment discretion. Tr. 1928:18 – 1929:8, 2239:23 – 2240:18, 2246:11-15. Smith had a limited role with the Pre-2003 Trusts: as Lex stated, McGinn "ran the alarm notes[,]" with which Smith had only "minimal involvement." Tr. 1568:13-22. Smith had no role in the due diligence for the Pre-2003 Trusts and the Pre-2003 Trusts due diligence team left MS & Co. before the Four Funds' formation. Tr. 4568:13-19, 4582:8-21.

- ***Conflicts of interest.*** There were obvious conflicts of interest between the Four Funds and Trusts and MS & Co., Smith and McGinn. ID at 91-92; *see* Div. Jt. Resp. at 20. For the Four Funds, Smith controlled the issuer (the LLC), placement agent (MS & Co.), sole owner

[2] The Four Funds have nearly identical PPMs. *Compare* DE 5 *to* DE 6, 9, 12. DE 5, the FIIN PPM, illustrates features common to all Four Funds.

and managing member (MS Advisors, an MS & Co. affiliate for which Smith served as principal), and trustee and servicing agent (MS Capital, another affiliate Smith owned and controlled). *See* DE 5 at 1, 7, 12, 15, 22, 23. Smith had sole discretion over Four Funds' investments. Tr. 1928:18-24. The Trusts PPMs disclosed that either MS Capital, as trustee, or MS & Co., as placement agent, would experience a conflict of interest with respect to due diligence, and "therefore, its due diligence review cannot be considered independent."[3] *See, e.g.*, DE 267 at 15, 63 at 10, 27 at 13-14, 264 at 9. Guzzetti's expert was unaware of a situation where the broker-dealer was both the issuer and the placement agent for a private placement. Tr. 4771:14 – 4772:13.

- ***Transactions with affiliates.*** The Four Funds PPMs disclosed that the LLCs could transact with affiliates. ID at 92. Affiliated transactions are viewed with suspicion, *see* Div. Jt. Resp. 20, and this disclosure should have prompted further inquiry by Respondents. ID at 92; Tr. 721:6-16, 1033:14 – 1034:15 (Division's expert testimony).

- ***Smith was secretive regarding how he invested Four Funds proceeds, despite promises in the PPMs of financial transparency.*** The Four Funds' ability to meet payment obligations depended entirely on the quality of the underlying investments, as selected by Smith. *See, e.g.*, DE 5 at 13. The PPMs provided that upon request, the Funds would "provide to [noteholders] our annual statement of the operations consisting of a balance sheet and income statement." *See, e.g.*, DE 5 at 21. But Smith insisted on secrecy. As he told Chiappone in response to a December 30, 2008 email "requesting a list of [TAIN] investments": "Frank, I have repeatedly told all of those who have previously requested this information that it is

---

[3] Indeed, the Receiver testified that due diligence for the Trusts was poor: "there was very poor underwriting of the investments . . . . [It] was wrong often enough that I have come to the professional conclusion that it was not well run." Tr. 2477:17 – 2479:13.

confidential." DE 425. Rabinovich explained: "Mr. Smith ... was sort of reluctant to give out specific financial information ... [including] what types of investments were in the portfolios, because it was a confidential nature to some of those investments, especially some of the loans that he was making to sort of local area companies, so there was a hesitancy on his part to talk or full disclosure on the portfolio." Tr. 1932:6 – 1934:9. Guzzetti called Smith "very reluctant" to provide Four Funds financial information, noting "that was the policy of these funds." Tr. 1314:19 – 1315:7. The Division's expert testified it was unusual for issuers like the Four Funds to keep investment information from brokers. Tr. 1285:9-17; *see* Div. Jt. Resp. at 21.

- ***The Four Funds PPMs limited sales to accredited investors only.*** The Four Funds PPMs offered "notes ... only to 'accredited investors.'" *See, e.g.,* DE 5 at 3, 10, 23. Respondents nevertheless sold Four Funds notes to numerous unaccredited investors, which they did utilizing a subscription agreement that asked those customers to incorrectly attest that they were accredited. DE 531, 532, 533, 534 (summary charts of Respondents' sales to unaccredited investors); Tr. 1997:20 – 1999:17, 3362:16 – 3365:10.

- ***Smith required brokers to find a buyer for maturing notes in order to redeem existing customers.*** By at least December 2006, Smith required brokers seeking to redeem an existing Four Funds note to find a new customer to purchase that note in a secondary sale. *See* DE 16, 17, 18, 20, 118, 119, 120, 155; Div. Jt. Resp. Addendum A. This was a significant departure from the PPM, which provided that redemptions would be made from underlying assets and their cash flow, and contained no language making redemption contingent upon finding a new customer. *See, e.g.,* DE 5 at 12. Lex's expert Charles Bennett agreed that "one of the hallmarks of a Ponzi scheme is using fresh money to pay off earlier investors." Tr. 4159:16-

21; *see also* Lex Ex. 147-A at 2 (requirement that "brokers [find] a replacement customer, as a condition to redeeming [an] existing customer[], would be a red flag").

- ***The January 8, 2008 meeting and January 2008 Four Funds default put certain Respondents on notice of fraud at MS & Co.*** Guzzetti, Livingston, Rabinovich, and Mayer attended a January 8, 2008 meeting with Smith and McGinn regarding the Four Funds. Tr. 1955:19 – 1956:16. Before this, Guzzetti had told all brokers in June of 2007 that MS & Co. deals were not correlated "to the shaky stock market." DE 111. Smith discussed for the first time the Four Funds investments in "great detail" and provided attendees with an asset list. Tr. 1956:17 – 1957:22; ID at 92. Attendees learned that the Four Funds were in "serious financial trouble;" carried out a number of related-party transactions—including extending loans to McGinn Smith-related entities, like the $8.8 million worth of loans to alseT—and were not as diversified as Smith had represented. Tr. 2028:9-17, 2033:5-11, 2036:9-13; ID at 92. McGinn told the attendees that MS & Co. needed to "pump out the swamp," and find ways to "drive revenues to the [Four] funds," and he committed to take a portion of MS & Co.'s revenue going forward for the benefit of Four Funds investors. Tr. 2065:19 – 2069:9, 2076:23 – 2077:17. This should have prompted Respondents to ask questions regarding future Trusts, none of which disclosed that revenues could be diverted to Four Funds investors.

All Respondents knew, or should have known, that beginning on January 15, 2008 and continuing through that year, their Four Funds customers received letters notifying investors of reduced interest payments but blaming the equity and credit markets. DE 132, 190, 192, 194-96. This reduction in interest on the Four Funds junior notes constituted an Event of Default, as defined in the Four Funds PPMs, because it was "a failure to pay interest on a note" and a "failure to observe or perform any material covenant." *See, e.g.,* DE 5 at 19. An event of default allowed the trustee or the holders a majority of outstanding notes to "declare the unpaid principal and any accrued interest on the notes to be due and payable immediately." *Id.* Even Lex's expert agreed that the Four Funds default was a red flag. Lex Ex. 147 at 18. Selling Respondents nevertheless continued to sell MS & Co. products post-January 15, 2008. *See* DE 58-67, 85-106, 108-109, 111-123; DE 591.

- ***Certain Trust Offerings disclosed exorbitant fees and/or were created to redeem earlier Trust investors.*** Certain Trust Offerings presented obvious red flags on the face of their PPMs, both in the form of exorbitant fees and/or redemption issues. *Supra*, at 4.

- ***McGinn and Smith concealed the Firstline Security, Inc. bankruptcy.*** The Firstline offerings occurred in May and October 2007. DE 27, 28, 439, 463. Smith and McGinn funneled $935,000 in investor proceeds to themselves. DE 2 ¶¶ 83, 85. On January 25, 2008, Firstline Security Inc., the company that owned the underlying assets, filed for bankruptcy, DE 251 at 3, leaving no cash flow to pay Firstline investors. DE 2 ¶¶ 86-87; *see also* Tr. 2489:7-13 (Receiver: "it was clear that this risk [of bankruptcy] came up in the due diligence"); DE 587, 588. Chiappone, Lex, Mayer and Rabinovich nevertheless continued to sell Firstline after the public bankruptcy filing. DE 2 at 66, 101, 112, 120. McGinn and Smith told brokers about the bankruptcy on approximately September 3, 2009. Tr. 1706:24 – 1707:20, 2139:24 – 2140:18, 2578:12-24, 3192:12-22; *see also* DE 250. To pay Firstline investors, MS & Co. further comingled Trust assets, using approximately $2 million from TDM Cable Trust 06, TDM Verifier Trust 07, Integrated Excellence Jr. Trust 08, TDM Luxury Cruise Trust 07, and TDM Verifier Trust 07R, and TDM Cable Funding, LLC. DE 2 ¶ 88.

ARGUMENT

I. Selling Respondents Violated the Securities Laws

Selling Respondents violated the securities laws through their fraudulent sales of millions of dollars of MS & Co. securities.[4]

A. Frank Chiappone

Chiappone argues, contrary to clear precedent, that (i) he was not required to conduct any investigation into the securities he sold as a matter of law (Chiappone Br. 13-14); and (ii) that his material misrepresentations and omissions to customers should be excused for lack of scienter. *Id.* at 21-25. But Chiappone grossly misstates the law governing his duties as a registered representative (Joint Br. 13-17), and his claimed lack of scienter collapses on his false premise that he "had no information" suggesting MS & Co. productions were not "legitimate investments" until after he left the firm. Chiappone Br. 26.

1. Chiappone Knowingly or Recklessly Recommended the Four Funds and Trusts

Chiappone admits he never conducted any meaningful investigation into the Four Funds, having instead "relied heavily on other people at McGinn Smith to investigate whether [they] were suitable investment products." Tr. 2657:8-12. Chiappone does not offer any evidence indicating his approach changed when he sold the Trust Offerings.

Chiappone explained that his "investigation into due diligence performed for any Four Funds investments" was limited to "inquiring early on [into] the nature of the type of investments Mr. Smith would have been looking to place into the Four Funds." Tr. 2657:13-19. But Chiappone conceded that Smith never told him about how MS & Co. planned to invest Four Funds proceeds. Tr. 2664:21-2665:14. And at least until December 2008, Chiappone never

---

[4] The Division addresses Selling Respondents' Section 5 violation in its response to Respondents' Joint Brief. Div. Jt. Resp. at 27-31.

asked McGinn or Smith for any Four Funds-related annual statement of operations, balance sheet or income statement or other information reflecting total assets as compared to notes payable. Tr. 2691:20-2692:10. But that lack of knowledge about the Four Funds did not stop Chiappone from concluding that the notes should be marketed to investors seeking safe investments for their retirement accounts, even for those seeking "very conservative" investments. Div. Ex. 424; Tr. 2763:15 – 2764:14.

Chiappone claims his lack of diligence was motivated in part by his belief that prior MS & Co. deals had been successful. Tr. 2666:14-2670:13. But Chiappone was faced with red flags regarding MS & Co.'s supposed success. Chiappone knew that the Four Funds were newly created entities with no operating history and had a much different investment mandate compared to the Pre-2003 Trusts. Tr. 2672:6-2673:5. Chiappone also knew that the Pre-2003 Trusts—whose purported success led him to recommend the Four Funds—were "taken out" with proceeds from the IASG IPO. Tr. 2693:7-22.[5]

Chiappone's claimed reliance on others at MS & Co. to do his job is also no defense. Chiappone Br. 15-17. A broker must discharge his own obligations to understand the products he recommends, Div. Jt. Resp. 17-19, and Chiappone was particularly ill-situated to rely so heavily on MS & Co. for due diligence, as (i) he knew "that the due diligence team that looked into alarm notes in 2003 and before ... were no longer employed by McGinn Smith"; and (ii) never even asked who was assigned the task of performing due diligence for similar investments once that due diligence team left. Tr. 5647:7-5648:23. Chiappone's abdication of his responsibility to investigate McGinn Smith products was particularly glaring given his

[5] Chiappone claims (Chiappone Br. 4) to have learned only recently that many Pre-2003 Trusts were rescued with IASG proceeds, but his testimony said otherwise. Tr. 2692:11-2693:22.

understanding that ""[i]f companies were coming to McGinn Smith to raise capital, they ... most likely had some blemishes on their balance sheet," Tr. 5477:6-21, and that companies with such blemishes were less likely to repay their loans. Tr. 5641:25 – 5642:20.

Moreover, Smith concealed specific information from Chiappone, a fact that, by itself, was a major red flag. When Chiappone finally asked for a list of investments in TAIN in December 2008, Smith told him: "Frank, I have repeatedly told all of those who have previously requested this information that it is confidential." DE 425. Chiappone testified that such stonewalling was "the same response [Smith] had all along," and Chiappone "just left it at that" rather than ask further questions. Tr. 2663:14-23.

When Smith told Respondents the Four Funds were failing due to market factors beyond his control, Chiappone quickly realized that Smith's "market meltdown explanation" was, in Chiappone's words, "a nice screen." DE 231; Tr. 2631:11-14. Chiappone continued: "It is not our fault that you [Smith] mis-managed the investments." DE 231. But Chiappone continued selling McGinn Smith products after he came to distrust Smith. As the ALJ explained: "Most damning to Chiappone's claim that he was an innocent bystander" to others' fraud was his continued efforts to sell McGinn Smith products even after writing an email in August 2008 "accusing Smith of mismanaging the Four Funds' assets" and challenging Smith's claim that a "market meltdown" caused the Four Funds' failure. ID at 99. Thus, Chiappone's argument that anything relating to the Four Funds could not possibly constitute a red flag for later offerings should fail (Chiappone Br. 22), as Chiappone sold many of those later Offerings after arriving at the conclusion that he could not trust the man behind those deals. Remarkably, Chiappone—who, like Smith in 2008, is looking for someone or something else to blame for his misconduct—now embraces Smith's very market meltdown screen as a reason the Four Funds collapsed. Chiappone Br. 5, 23.

Indeed, when Chiappone learned that, contrary to what he had told his customers, each of the Four Funds held many of the same investments, he found this "incomprehensible." DE 231. But even upon realizing his boss was lying to him about McGinn Smith investments—or, as Chiappone put it, he had reason to "second guess" what he was hearing from MS & Co. about their securities, Tr. 5502:4-10—Chiappone did not respond by asking more questions. He went on recommending McGinn Smith products without sharing his concerns about McGinn Smith management with his customers, instead telling customers that he was confident in McGinn Smith products based on how they performed in the past.[6] Tr. 2623:18–2624:13. In fact, Chiappone did not even mention the 2008 Four Funds defaults when discussing new MS & Co. products with his customers. Tr. 2642:18-2643:8.

A full year after writing his letter to Smith, Chiappone was still blindly recommending and selling products without conducting any meaningful investigation. DE 2 at 66 (reflecting August 2009 sales). For example, Chiappone knew that more than ***one third*** of the proceeds raised from the Benchmark offering would be reserved for "fees and expenses and things other than the underlying assets," Tr. 2618:6-15; DE 63 at 8, and he knew that the Benchmark PPM described conflicts of interest relating to MS & Co. and its role performing due diligence, Tr. 2626:7-13, but neither the exorbitant fees nor MS & Co.'s conflicts led Chiappone to conduct a more searching analysis into whether the Benchmark notes were suitable investments. Tr. 2626:14-2627:11. To the contrary, Chiappone specifically relied on McGinn to provide

6 Chiappone also understood that he needed to have "replacement tickets" whenever a client wanted to redeem Four Funds investments, but this also did not cause Chiappone to question Smith about those investments. Tr. 2698:13-2699:2; 2702:7-2703:8; DE 427, 428.

information about the Benchmark offering even after Chiappone learned of his bosses' deceit regarding the Firstline investments. Tr. 5626:4 – 5627:3, 2618:16 – 2620:3.

Chiappone similarly buried his head when selling TDM Verifier "R" notes. He understood that both TDM Verifier Trust 07R and 08R existed to retire certificates in prior TDM Verifier offerings, rather than to invest in new, potentially profitable, ventures. Tr. 2609:16 – 2610:3. But Chiappone sold those trusts too, Div. Ex. 2 at 66-67, and did so without even investigating whether the initial TDM Verifier Trusts (the ones replaced by the "R" Trusts) had sufficient income to pay off their investors absent an infusion of cash from new investors in the "R" Trusts, Tr. 2612:25-2613:14, or looking into the obvious duplication of costs caused by creating new trusts simply to pay investors in prior trusts. Tr. 2611:21-2612:24. Thus, Chiappone's argument that this case does not resemble those involving the sale of securities for companies "already in financial distress" (Chiappone Br. 14) is contrary to the clear record, which demonstrates that the very purpose of many of the MS & Co. deals were to "pump the swamp" to cover for prior failed ventures.

Finally, as for all Respondents, disclosures in the PPM concerning red flags like conflicts of interest and transactions with affiliates do not relieve Chiappone of his responsibility to investigate and understand the securities he sold, Div. Jt. Resp. 20-22, but for Chiappone, such reliance on the PPMs (Chiappone Br. 20) is particularly disingenuous, as Chiappone admits that he failed to read portions of the very PPMs he used to sell McGinn Smith offerings. Tr. 2673:6-11, 2605:3-21, 2705:4-2706:2.

2. <u>Chiappone Made Material Misrepresentations and Omissions</u>

As time went on, Chiappone learned with even more certainty that Smith and McGinn were not dealing with him honestly. On September 3, 2009, Chiappone learned not only of the

Firstline bankruptcy, but also that Smith and McGinn had concealed the bankruptcy from him. Tr. 2578:12 – 2579:12; Chiappone Br. 18-19. At that time, "it occurred to [Chiappone] that McGinn Smith must have been paying interest on the notes with monies raised from other customers in other offerings." Tr. 2581:20 – 2582:6, 2588:9-24, DE 641 at 11. But even this bright red stop sign did not stop Chiappone from continuing to sell McGinn Smith securities. On November 3, 2009 Chiappone sold a McGinn Smith Benchmark investment without disclosing his concerns about his bosses' trustworthiness. Tr. 2577:20 – 2578:7, 2623:18 – 2624:13. Chiappone apparently concedes that he has no credible excuse for making that sale, so he instead argues that the violation—a $50,000 sale, DE 2 at 67—should be deemed a "*di minimus*" violation. Chiappone Br. 19.

And Chiappone's lies did not stop there. Chiappone told one customer, Gary Ardizzone, that the Four Funds were conservative investments, and Chiappone led Ardizzone to believe, incorrectly, that the Four Funds were alarm deals—*i.e.*, investments with interests in alarm-related products, similar to products Ardizzone had purchased before. Tr. 2764:11-14; ID at 100.

In fact, Chiappone's last sale to Ardizzone came in October 2008, DE 2 at 66, *after* Chiappone penned his letter to Smith making clear Chiappone's distrust of his boss, but Chiappone never mentioned any concerns to Ardizzone, who would have "run like a scared rabbit" had Chiappone not omitted such material information. Tr. 2774:21 – 2775:7. Likewise, Chiappone never told Bruce Becker—who purchased McGinn Smith securities from Chiappone as late as December 2008, DE 2 at 64-67—about any Chiappone's concerns about Smith's trustworthiness or about problems with the Four Funds. Tr. 2908:9-16, 2920:3-11, 2922:23—2923:2.

B. William Lex

Lex claims "it is impossible to comprehend" how he could be liable for fraud. Lex Br. 2. The overwhelming evidence, however, proves that Lex—by far the top selling broker at MS & Co.—knowingly sold the Four Funds and Trusts "when he had done no investigation" and was "simply repeating the issuer's unchecked representations." ID at 103; DE 2 at 85-103.

At the hearing, Lex showed no remorse for his conduct, which had devastating consequences. When asked about his responsibilities to his customers, Lex responded merely that "I had no idea that I was supposed to be auditing McGinn Smith's activities." Tr. 1610:11-18. Moreover, the ALJ found Lex's conflicting and inconsistent testimony "highly suspect."[7] ID at 103.

1. Lex Knowingly or Recklessly Recommended the Four Funds and Trusts

Lex's sales of the Four Funds and Trusts were continuous throughout the period of the fraud. DE 2 at 85-103. Lex knew next to nothing about how Smith and McGinn used the $45.5 million he had raised from his clients, relying instead on the untenable belief "that David Smith operated in a truthful manner." Tr. 1575:24 – 1576:11.

Against the evidence, Lex insists that "there were no red flags that required investigation," and argues he was not required to undertake "detective work." Lex Br. 15, 17. But Lex fully understood the red flags apparent in the Four Funds' PPMs, which he read "cover to cover." Tr. 1567:4-10. Yet the conflicts of interest disclosed in the PPMs did not prompt him

---

7 The ALJ's credibility determinations should be afforded "considerable weight." *Robert M. Fuller*, Rel. No. 8273, 2003 WL 22016309, at *7 (Aug. 25, 2003) (the Commission ordinarily "give[s] considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses testimony and observing their demeanor. ... Such determinations can be overcome only where the record contains substantial evidence for doing so.").

to ask questions. Tr. 1573:15 – 1575:5. He knew FIIN was a brand new LLC with no history of performance. Tr. 1568:7-12.

Lex never saw, or even requested, basic financial information, such as a balance sheet or income statement, for any of the Four Funds. Tr. 1600:24 – 1601:3, 1625:16 – 1626:25. He "didn't think registered reps had that responsibility." Tr. 1629:20 – 1630:7.

Despite relevant disclosures in the PPMs, Lex never asked Smith about the Four Funds' affiliated transactions even though he knew that redemption at maturity depended entirely on the performance of underlying investments. Tr. 1575:6-23, 1597:2-12; *see also id.* 1593:16 – 1594:5 (did not know FIIN funds redeemed Pre-2003 Trust investors but "absolutely" would have been concerned).

Moreover, from 2004 through 2006, Lex asked Smith "a number of times" for information on the Four Fund investments, Tr. 1608:14-20, but Smith stonewalled him: due to confidentiality concerns, Lex testified, "they weren't disclosing specific companies. . . . [only] broad parameters of the types of companies. . . . after the investments were purchased."[8] Tr. 4936:11-4938:5; *see also id.* 1604:20 – 1605:14, 1615:2 – 1616:7.

Lex said Smith claimed borrowers "provide a lot of confidential information and didn't want that information disseminated throughout the community . . . all this stuff is confidential. I accepted that." Tr. 1608:24 – 1609:19. This never caused Lex any concern because he considered Smith "an honest businessman." Tr. 1609:25 – 1610:10.

Far from being exculpatory (Lex Br. 19), Lex's receipt of a "Portfolio Analysis" for FIIN and TAIN underscores his utter failure to confront red flags. *See* Tr. 4942:5 – 4943:4 (discussing Lex. Ex. 63); DE 407. Lex testified that he was told "there were no defaults and everything was

---

8 At the hearing, however, Lex claimed to recall some of the investments, though even this was murky. Tr. 1598: 21 – 1600:11, 1612:5 – 1613:2.

performing." Tr. 1653:19-22; *see also* Lex Ex. 41. But the Analysis showed FIIN and TAIN were heavily invested in affiliated entities, including alseT, MS & Co.-controlled entities and the Pre-2003 Trusts, and that TAIN had loaned $400,000 to FEIN. DE 407 at 5; Lex Ex. 63; *see also* Tr. 4945:15-4946:2, 4946:17-24. "It didn't dawn on" Lex, however, to inquire as to why one of the Four Funds loaned money to a Pre-2003 Trust. Tr. 4947:21-25.

Despite these red flags, when the Trusts became available in late 2006, Lex had no concerns. Tr. 1627:2-24. Lex read the PPMs and had conversations with McGinn, Tr. 1607:22 – 1608:13, and believed that "there was an extensive amount of people behind the scenes." Tr. 1637:9 – 1639:14. Otherwise, Lex did no due diligence or investigation regarding the Trust Offerings. Tr. 1607:6 – 1608:13.

Lex also knew that investors holding maturing notes were being redeemed with new investments (DE 20; Tr. 1698:9 – 1700:10), which Lex's own expert witness admitted "would be a red flag, which would require further inquiry[.]" Lex Ex. 147-A at 2. And emails abound demonstrating Lex's efforts to find "replacement tickets" for his redeeming customers. *See* DE 279, 281, 160, 125, 500.

Even more troubling was Lex's effort to secure preferred redemptions for himself. On May 5, 2008, for example, Lex emailed Guzzetti to ask "[w]ith the money that has come in, will I be redeemed for any of my 1-Yr. FIIN and /or TAIN?" DE 163. Frustrated with this policy but nevertheless still willing to continue his sales, Lex emailed McGinn that he was "just desperate to keep some credibility with [his] clients so they will keep investing in McGinn, Smith & Co., Inc. products." DE 166.

Lex also claims that his absence from the January 8, 2008 meeting is somehow exculpatory. Lex Br. 15. By that point, however, Lex already knew, as a result of the August

2007 Portfolio Analysis, that Smith was using Four Funds proceeds to redeem pre-2003 investors and to make "loans" to numerous other McGinn Smith entities. Lex also knew or should have known about the January 2008 Four Funds default.

Other evidence confirms Lex's scienter. On January 25, 2008, Lex emailed Smith:

> I think the fiduciary responsibility to the clients has been breached since none of these clients were aware of the pending problems in [TAIN]. I have been talking to the clients about the liquidity problems of the notes and clients have expressed concern that they were mislead [*sic*] about material characteristics of these investments. I was not aware that the same investments were put in each note. I went out of my way to make sure clients were spread amongst the various notes so that they would have DIVERSIFICATION.

DE 161.

On January 5, 2009, Lex, referring again to MS & Co.'s failure to pay interest and principal, emailed McGinn, Smith, and Guzzetti to complain that "this raises a credibility problem with our clients and raises doubts about the efficiency of our operation." DE 137. Lex further wrote that he had already had three calls from investors and that "[i]t is tough making excuses for the inexcusable! It is getting harder to make repeat sales to clients that are skeptical and unnerved." *Id.*

Later in January 2009, Lex forwarded to Smith and Guzzetti an email from a customer seeking to redeem a Firstline note to avoid "getting burned again." DE 165. Lex told Smith and Guzzetti that "[t]his is the type of reaction I am getting from my clients." *Id.* On April 7, 2009, Lex emailed Guzzetti, Smith, and McGinn describing one of his customers as "one of many people who refer to our deals as a Ponzi Scheme. I try to reassure my clients that McGinn, Smith & Co., Inc. does not run Ponzi Schemes but the uproar is getting louder and louder from clients . . . Most of the people whose money is tied up in TDM are still upset about what happened with the [Four Funds]. DE 167. Lex nevertheless continued to sell Trusts throughout 2008 and the first half of 2009. DE 2 at 101-03.

Lex also knew his clients suffered. In September 2008, Lex emailed Smith to express concern about his clients that "live off of the income from the notes," that their "only other regular income is modest [s]ocial [s]ecurity," that without this income they "are in a cash crunch," and that "the most important issue is whether they'll get return of principal." DE 164; *see also* DE 169.

Lex also emphasizes his own "substantial investments" in the Four Funds. Lex Br. 2. Lex, however, used his own purchases to market the funds, which helped conceal the fact that Lex knew nothing about how his customers' funds were being used. *See* Tr. 1514:11 – 1515:8, 748:15 – 749:3. And in the later years of the fraud, Lex invested to inject much needed liquidity into the funds. *See* DE 167.

Lex also argues that the ALJ failed to give "significant weight" to the opinion of his expert witness, Charles Bennett, who opined that Lex reasonably accepted Smith's secrecy about the investments. Lex Br. 19. The PPMs make clear that noteholders, upon request, would be provided "our annual statement of the operations consisting of a balance sheet and income statement." *See, e.g.,* DE 5 at 21, 24. Thus, secrecy was not at all reasonable.

In any event, Smith's invocation of "confidentiality" does not abrogate Lex's duty of inquiry. As even Lex's expert Bennett stated in his report, "Lex (and the other registered representatives) have a duty established pursuant to long standing custom and practice in the industry to take reasonable steps to understand the securities that are offered through their broker dealer on behalf of an issuer in a private offering." Lex Ex. 147 at 5.

2. Lex Made Material Misrepresentations and Omissions

Lex's argument that he made no misrepresentations and omissions to his customers is based on his claim that merely describing the Four Funds and Trusts as "safe" is not a basis for finding liability. Lex Br. 11. But Lex's fraud arose from his failure to disclose to customers his lack of due diligence in the face of red flags, and his recommendation of securities he did not understand. As Lex admitted, his customers never knew he was unaware of underlying investments. Tr. 1606:10-18 ("I don't recall conversations where that topic came up."). In sum, Lex knew that he had no basis to make statements to customers about the safety of the investment.

Lex's brief cites to more than a dozen private securities cases standing for the principles that "statements of hope" and generalized assertions of future performance are not actionable. Lex Br. 11-14. Those cases, however, are not factually analogous and do not contemplate a broker who has sold $45 million of private placements without telling those customers anything about mounting problems at his broker-dealer or that he had not conducted any due diligence.

Similarly, Lex's argument that "customers are imputed with notice of disclosures they receive in writing in the PPMs" misses the point. Lex Br. 25-26. For the reasons discussed in the Division's Response to Respondents' Joint Brief at 23-25, Lex's efforts to blame his customers fail.

As the ALJ found, Lex victims, Alice Forsythe, Barbara Monahan and Marvin Weiner, were "three credible witnesses who were unsophisticated investors [and] gave compelling, persuasive testimony that Lex recommended private placements for their retirement funds, which Lex knew they were going to need to live on. Lex did not inform any of these investors of the risky nature of private placements or investigate and resolve any of the other red flags surrounding the offerings." ID at 103. Lex's only response is that the investors should have paid more attention to the warnings in the PPMs and ignored his oral assurances. Lex Br. 14-15. Even had the investors done so, Lex's complete failures to conduct due diligence was never disclosed.

C. Thomas Livingston

Livingston—who worked at MS & Co. for more than 20 years and, during the fraud, was Vice President and 20% owner of the firm—portrays himself as a blameless victim of McGinn's and Smith's crimes, nothing more than an "innocent conduit[]" used to further the nefarious scheme. Livingston Br. 17. He argues that detecting the fraud was "virtually impossible," even for someone like him who "has been in the securities industry for over 35 years," and claims that he has "a very strong reputation for integrity and truthfulness" and an "'impeccable'" character. *Id.* at 1, 4.

But the evidence shows that Livingston sold the Four Funds and Trusts without reasonable basis or investigation and made numerous material misrepresentations and omissions. Indeed, Livingston is especially culpable for his instrumental role in the Four Funds' undisclosed diversion of $8.8 million to alseT, a failed venture-capital start-up where Livingston served as President. Tr. 5301:3-4. Rather than share information about alseT with his customers and fellow brokers, Livingston exited MS & Co. in 2009 before anyone else, having profited enormously during the fraudulent scheme to the tune of $2 million from MS & Co. and another $640,000 from alseT (all from Four Funds investors). DE 681, 682.

1. Livingston Knowingly or Recklessly Recommended the Four Funds and Trusts

Livingston's argument that he conducted sufficient due diligence of the Four Funds and Trusts, Livingston Br. 18-19, fails. As "evidence," he cites his own testimony, during which his counsel had him review the Four Funds' balance sheets and identify which investments he was "aware of," Tr. 5209:24-5210:18, and that Smith's office was "10 feet from me" and the "CFO was 20 feet from me." *Id.* 2260:4-21. But "Livingston was not a credible witness" and "[m]ost of his positions . . . are so lacking in substance that for someone with his background, they are naïve, unprofessional, and implausible." ID at 104.

Indeed, no contemporaneous evidence exists to support Livingston's claims of any reasonable investigation. On the contrary, Livingston testified: "[D]id I do a deep dive as far as the whole due diligence? The answer to that would be no." Tr. 2243:16-2244:9. Livingston never asked Smith for a Four Funds balance sheet or income statement though the PPMs promised such information. Tr. 2259:8-15; DE 5 at 21; *see also* Tr. 2259:16 – 2260:3. Livingston did not think it was necessary to ask for financial information simply because it "[d]idn't occur to [him] that there was a problem with the investments that [Smith] had made." Tr. 2261:21 – 2262:3.

Livingston failed to investigate the products he sold despite facing obvious red flags, including those described in the PPMs. For example, Livingston knew about serious conflicts of interest concerning the Four Funds. Tr. 2237:14 – 2239:3. Livingston "did not have concerns" with Smith's total control over everything concerning the Four Funds, Tr. 2239:4-11, because the Pre-2003 Trusts "had gone off without any . . . problems whatsoever." Tr. 2239:12-22. Livingston understood, however, that the Four Funds were completely different "in structure" from Pre-2003 Trusts. Tr. at 2239:23 – 2240:18.

Similarly, Livingston read the FIIN PPM's restrictions concerning affiliated transactions, Tr. 2258:12-24, Div. Ex. 5 at 23, but never asked Smith whether he complied with that provision, or even whether he engaged in any transactions with affiliates. Tr. 2258:25 – 2259:7. Because he asked no questions, Livingston had no understanding that by 2007 more than half of money invested in the Four Funds was invested in MS & Co. affiliates. Livingston concedes he would have been concerned had he known this. Tr. 5350:13-17. Livingston's failure to inquire is even more egregious in light of his diversion of $8.8 million from Four Funds investments into the risky and unprofitable alseT venture.

By December 2007, Livingston explicitly acknowledged that the Four Funds' investment strategy was riddled with conflicts of interest, affiliated transactions, and was untenable. He wrote to McGinn and Smith:

> Let's be honest here. The fact that the funds under McGinn Smith control have combined losses approaching some $45 million dollars! There is another $20 million in Coventry (lets not forget the HUGE conflicts here) that are all teetering on the brink of calamity. Do you think that these facts might have something to do with the franchises potential meltdown. It is disingenuous to say that my position on this issue risks the franchise. Yes $8.7 million of the $45 million is alseT related. This is not an insignificant sum by any measure. . . The fact that suddenly we are at risk of client lawsuits because of the obvious conflicts that existed between borrower [alseT] and lender [the Four Funds] seems unbelievable to me. . . . I have drawn the conclusion that if the loan goes bad a case is being built to point the finger at me.

DE 585 at 4. Although Livingston dismisses the "ALJ's reliance" on this memo as "misplaced," Livingston Br. 12-15, it is strong evidence of scienter and his actual knowledge of serious red flags.

Livingston knew, or should have known, about other serious red flags, such as the Pre-2003 Trust failure, Smith's inexperience with offerings like the Four Funds, the Four Funds' limitation of sales to accredited investors only, and the January 2008 Four Funds default. Tr. 2246:11-15, 2239:23 – 2240:18, 2293:22 – 2294:9, 2251:18-25. He also sold TDMM Cable Jr. Trust 09 in June 2009, which disclosed a 21.9% fee. DE 2 at 108, 151; *see also* DE 1 at 27.

2. Livingston Made Material Misrepresentations and Omissions

Contrary to Livingston's argument, Livingston Br. 7, Daniel Ferris and David LaFleche—both unsophisticated investors who, on Livingston's recommendation, invested their retirement funds in Four Funds and Trusts—testified as to Livingston's many misrepresentations and omissions. *See* ID at 104.

Ferris testified that in November 2007 he gave Livingston a $25,000 check that had been given to his wife from her ailing mother. Ferris told Livingston "to not put it in the trust or anything that had long term returns but get it in something where it would be liquid and if I needed it right away I would be able to do that." Tr. 38:5-39:13; DE 597. Ignoring Ferris' instructions, Livingston invested the $25,000 in TDM Luxury Cruise Trust 07 in November 2007 without disclosing the significant risks.[9] Tr. 39:14-40:11; DE 596; DE 2 at 108.

LaFleche testified that "Tom knew [his investments] was all the money I had and it was an inheritance and it was important to me that it be invested conservatively." Tr. 92:11-12; DE 2 at 108. In October 2008 and January 2009, when Livingston knew all about the "catastrophe" at MS & Co., he nevertheless recommended that LaFleche invest another $45,000 in MSTF and TDMM Cable. LaFleche recalled that Livingston "called me and recommended that I put it in [MSTF]. . . . [Livingston] said when they do deals, you know, they are very profitable. I said to Tom the same thing I always said to him . . . 'Is it safe and secure? This is all the money I have.'" Tr. 91:24 – 92:16.

9 Although Livingston maintains Ferris's testimony was "completely inaccurate," Livingston Br. 8 n.2, Ferris' clear recollection of Livingston's failure to disclose risk was adopted by the ALJ, who did not conclude that Ferris suffered from any of the credibility problems that Livingston did. *See* ID at 46; Tr. 34:4-15. Moreover, Ferris authorized the $25,000 transfer, Liv. Ex. 65, but testified that he "didn't associate" this transfer with a TDM Luxury Cruise purchase, which he "certainly didn't approve" of. Tr. 67:25 – 68:8.

Moreover, Livingston, who knew that LaFleche's net worth was no more than $250,000, instructed LaFleche to represent that his net worth was more than $1 million. DE 633 at 4. Livingston told LaFleche: "'You have to change it to a million . . . In order to invest in these you have to change that." Tr. 90:5 – 91:13; *see also* DE 571 at 16-21 (LaFleche victim impact statement).

Despite these fraudulent dealings, Livingston argues that he could not have deceived Ferris and LaFleche because of the timing of their investments. Livingston Br. 7-9. Livingston argues that as of Ferris' January 27, 2006 FAIN note purchase, "there were no loans to alseT by FAIN to disclose." *See id.* at 8. FAIN transferred over $1 million to alseT just days after MS & Co. received Ferris' funds. DE 2 at 108, 156. As alseT president, Livingston knew or should have known about this transfer and knew that as of Ferris' purchase, alseT's only incoming cash was $2.585 million from TAIN. *Id.* at 156. Moreover, Livingston made numerous Four Funds sales without appropriate disclosures after the first transfer from TAIN to alseT in May 2005. DE 2 at 108, 156.

Livingston further argues that he did not need to disclose to customers the Four Funds transfers to alseT and his serious personal conflicts of interest. Livingston Br. 7-9. The fact that the Four Funds invested more than $8.8 million in alseT, a speculative venture capital start-up, was material to Four Funds investors because it was not an appropriate investment for a fixed term private placement like the Four Funds and glaring conflicts of interest, including Livingston's own alseT salary of $40,000 per month (in addition to his MS & Co. salary). Indeed, in June 2007, alseT's general counsel emailed Livingston that MS & Co. could be liable for conflicts of interest relating alseT loans and that "you will be part of the McGinn Smith litigation." DE 620 at 2.

Livingston downplays his role in the fraud by exaggerating alseT's potential for success, arguing that "alseT was about to obtain permanent financing" from Merrill Lynch and Goldman Sachs which would have rendered Four Funds loans unnecessary. *See* Livingston Br. 8, 12. This is false: Livingston's evidence—draft terms sheets—merely show preliminary discussions. Liv. Ex. 94, 97, 98. Livingston claims of a "legal opinion" blessing his alseT involvement, Livingston Br. 7 n.1, should also be rejected, as he could produce no evidence of any such opinion. Tr. 2283:6 – 2285:25.

Livingston also argues that Four Funds default letters disclosed "the financial troubles of the Four Funds," and that the ALJ should have considered them "in assessing [his] culpability." Livingston Br. 11. These letters, however, were in fact an integral element in Smith's fraud. *See* DE 132, 190, 192, 194-96. They disclosed no reasons for the Four Funds shortfall instead blaming a host of external forces, including equity and credit markets. Moreover, they cannot diminish the significance of Livingston's misrepresentations and omissions.

D. Brian Mayer

Mayer argues, against the evidence, that he never made "any material misrepresentations or omissions in presenting any McGinn Smith Security" and did not encounter red flags. Mayer Br. 1, 8-9, 11-15. Mayer also advocates—against a half-century of precedent—that brokers only have a duty to investigate when they "actively and knowingly participate in fraud." *Id.* at 1; *see also* Div. Jt. Resp. 17-19.

1. <u>Mayer Knowingly or Recklessly Recommended the Four Funds and Trusts</u>

Mayer's after-the-fact assertions that he investigated the Four Funds and Trusts before recommending them should be rejected. *See* Mayer Br. 5-6. The ALJ correctly described Mayer's credibility as "highly suspect because [he] gave very different testimony on the same subject at different times," including during the hearing itself. ID at 105. Mayer's lack of credibility is underscored by his repeated refusal to stand by his prior sworn statements. Tr. 3326:6-23; *see also id.* 3339:8 – 3341:6.

Mayer recommended MS & Co. securities without conducting any meaningful investigation. Mayer never asked for or saw a Four Funds balance sheet, or anything showing the total assets versus notes payable, Tr. 3328:22 – 3331:9, and "never did an independent investigation" to determine whether the interest rates that Smith selected for the Four Funds were achievable given the types of investments Smith intended to make, claiming reliance on others at MS & Co. to do this. Tr. 3335:24 – 3336:20. And Mayer was unable to provide "information about specific [Four Funds] investments to a client" because "[he] didn't have specific investments." Tr. 3290:9 – 3291:2; *see also id.* 3358:10-14.

Mayer failed to ask basic questions in the face of glaring red flags. *First*, the very PPMs he used contained clear red flags. Mayer confuses his disclosure obligations as to such warnings with his duty to investigate the securities he recommended. The troubling conflicts of interest Mayer writes off as "standard" disclosures, Mayer Br. 6, were red flags—*i.e.*, they alerted Mayer to a potential problem—and disclosing that potential problem was no substitute for further investigation. Div. Jt. Resp. 20; Tr. 3274:18-22 (Mayer read PPMs). Mayer nevertheless recommended these investments to his clients without further inquiry.

Similarly, Mayer knew that the Four Funds could, per the PPM, acquire investments from MS & Co. affiliates, but never asked basic questions about such transactions. Tr. 3299:9-21, 3301:6 – 3302:2; Mayer Br. 3-4. Simply disclosing potential affiliated transactions did not relieve Mayer of his investigative obligations. And Mayer's testimony regarding the Four Funds' affiliated transactions was incredible and inconsistent. *See* ID at 105. For example, Mayer admitted knowing that "McGinn Smith funds" invested in alseT, but claimed not to know whether the *Four Funds* made such an investment, despite having daily access to the alseT team, which worked out of his New York City office. Tr. 3304:20 – 3309:3; *compare* Tr. 3323:9-15 *with* Tr. 3323:16- 3324:25 (Mayer about-face from deposition to hearing). Mayer further claimed he did not know the magnitude of the alseT investment until January 2008. Tr. 3313:21 – 3314:15.

Mayer also ignored other language in the PPMs. For example, he knew Four Funds PPMs promised a balance sheet and income statement, but he never asked for one. Tr. 3274:5-17; *see also* Tr. 2826:23 – 2829:12. Mayer sold the Four Funds to unaccredited investors even though PPMs limited sales to accredited investors only. DE 531-32.

Mayer sold certain Trust Offerings that charged extremely high fees, leaving less money available for investment, DE 2 at 112-13, 149-51 (summarizing Trust fees), and sold TDM Verifier 07R, which was created for the express purpose of redeeming other investors. DE 268 at 7; DE 2 at 112-13. Mayer sold Fortress Trust 08 to his customers but did not question the 13% return promised in light of the September 2008 "economic climate" upon which he himself lays blame. Tr. 3445:8 – 3447:3; DE 202; DE 2 at 111; *see also* Mayer Br. 7. Indeed, during Fall 2008, MS & Co. was sending letters to Four Funds investors blaming the markets for the firm's inability to make interest payments or return principal. *See, e.g.,* DE 132, 188, 190, 192-196, 632.

Second, Mayer continued to sell MS & Co. products after learning of both the Four Fund's default and MS & Co.'s serious financial problems. Mayer attended the January 8, 2008 meeting. Although he dismisses this meeting as "unsurprising," the "economic climate in 2007 and 2008" (Mayer Br. 7) cannot explain the heavy affiliate investment and asset commingling

Smith revealed to the brokers. Incredibly, Mayer received commissions on new Four Funds sales after the January 8, 2008 meeting, DE 2 at 111, and Mayer does not recall sharing information he learned at that meeting with investors. Tr. 3389:24 – 3392:9.

Mayer attended a March 17, 2009 meeting, which included a review of the MS & Co. 2008 financial statements and net capital computation. Tr. 3397:18 – 3402:25; DE 80. Rabinovich testified that Mayer knew about the potential net capital violation by the second or third quarter of 2009, but Mayer continued to sell, and profit from, additional Trust sales. Tr. 2125:2-13, 2126:24 – 2128:11; DE 2 at 113.

Third, while Mayer now pleads ignorance regarding MS & Co.'s redemption problems (Mayer Br. 7), his sworn testimony indicates otherwise. Before denying knowledge of the redemption problems at the hearing, Tr. 3373:4-9, Mayer testified at his deposition about an "instruction that [brokers] had to find new clients before allowing existing ones to redeem," and he told other brokers that "the funds had limited liquidity, and if a client wanted to redeem, the client was not able to regularly redeem right now, so if the client had to redeem, you had to go out and create a market for it." Tr. 3373:10 – 33:75:17. Mayer also knew that Rabinovich's father was redeemed on a $600,000 Firstline "loan" using new customer funds and sold $100,000 worth of Firstline notes to help. Tr. 3409:7 – 3410:5, Tr. 3416:16 – 3417:22, 3418:19 – 3419:11; DE 2 at 154; *see also infra* at 36-37 (redemption of Rabinovich's father). And Mayer knew Rabinovich invested in TDM Verifier 11 in order to redeem another broker's client. DE 649; *see also infra* at 37.

2. <u>Mayer Made Material Misrepresentations and Omissions</u>

Mayer's claim that he never made any misrepresentations or omissions to investors, Mayer Br. 8-9, is belied by the evidence. That certain clients were satisfied with him does not change the fact that Mayer lied and failed to provide material information to his customers. For example, Mayer admits he omitted explanation of due diligence-related conflicts of interest regarding the Firstline securities he sold to his customers. Tr. 3442:3 – 3443:11. Mayer also did not disclose to three Firstline customers that the proceeds from their purchase would go toward Rabinovich's father's redemption. Tr. 3419:17 – 3420:6, 3423:5 – 3424:24.

Mayer's customers' testimony highlighted numerous material misrepresentations. Retiree [redacted] O'Brien, whom the ALJ deemed to be "credible" and "persuasive," *see* ID at 106, invested $190,000 from September 30, 2008 (after Mayer knew about the failure of the Four Funds) to September 10, 2009 (after Mayer learned of the Firstline bankruptcy concealment). DE 2 at 112-13. Mr. O'Brien had virtually no investment experience, Tr. 892:4-10, and his brokerage account application, signed by Mayer, noted a "moderate" risk tolerance and "limited" investment knowledge, with "income" as his top investment objective. DE 528 at 2.

Mayer touted MS & Co.'s supposed track record to Mr. O'Brien, *see* Tr. 900:5-13, but failed to mention that by 2008, problems at the firm had been mounting since at least 2003. For example, Mayer knew MS & Co. used the IASG IPO to redeem investors in many of the early deals he was touting as part of the firm's successful track record. Tr. 3264:20 – 3265:7, 3265:19 – 3266:17, 3302:18 – 3303:23. Mayer also knew, but did not relay, information he received at the January 8, 2008 meeting. Tr. 920:6-22. Mayer never told Mr. O'Brien about redemption issues. Tr. 920:23 – 922:8. Mayer told Mr. O'Brien that Fortress was a "good deal" and never pointed out the risks of the investment, leading Mr. O'Brien to view the Fortress investment as "safe." Tr. 901:14 – 902:12, 904:6-24.

Mayer learned of the Firstline bankruptcy on September 3, 2009, *see* DE 139, 251, but never told Mr. O'Brien that McGinn and Smith concealed the bankruptcy filing for more than one year. Indeed, Mayer never warned O'Brien not to wire funds for Benchmark, Tr. 913:17 – 914:2, which were received on September 10, 2009. DE 595. Mayer also never told Mr. O'Brien anything about MS & Co.'s financial health before he recommended Benchmark, Tr. 919:16 – 920:5, even though he already knew that MS & Co. was in serious financial trouble by that point. Tr. 3398:24 – 3400:23; DE 80.

Mr. O'Brien's sister, [redacted], invested $75,000 through Mayer and was planning to testify at the hearing, but suffered a stroke. Tr. 922:9-23; DE 2 at 112-13. Mayer told Ms. O'Brien, when asked if certain private placement investments were safe, that "he would swear on his father's grave that they were." Tr. 927:18 – 928:8.

[redacted] Alberts, a then 84-year-old retiree, testified regarding Mayer's material omissions and was also deemed to be "credible" and "persuasive" by the ALJ. ID at 106. Mr. Alberts invested 35-40% of his retirement assets in FAIN and TDM Verifier at Mayer's recommendation. DE 2 at 111; Tr. 3472:19-25, 3477:11 - 3478:3; DE 642. Mr. Alberts had limited investment knowledge and (based on his discussions with Mayer) thought his investments were "very safe." Tr. 3469:15 – 3470:20, 3478:9-22. Mayer never warned Mr. Alberts that he could lose all of his money. Tr. 3475:6-15, 3478:23 – 3479:2. Mr. Alberts, an unaccredited investor, recalled filling out documents representing that he was an accredited investor, but Mayer assured him not to worry about this. Tr. 3474:9-19; DE 642; RMR 733 at 2. Alberts recalls being told how to fill out his subscription agreement so as "not to raise any eyebrows about whether or not I was financially capable of investing in that note." Tr. 3500:23 – 3501:21.

[redacted] von Glinow, a retiree, also testified to Mayer's misrepresentations and omissions. At Mayer's recommendation, Mr. von Glinow invested $665,000 in the Four Funds and Trusts.

DE 2 at 111, Tr. 2808:3-10, 2812:13-20, 2814:6-11, 2824:9-10. Even though he had no knowledge of what was in the Four Funds portfolios, Mayer told Mr. von Glinow that FIIN and the other Four Funds "[were] totally independent of each other and diversified within each and amongst each." Tr. 2818:5 – 2819:17. Accordingly, Mr. von Glinow invested in FIIN, TAIN, and FAIN. Tr. 2817:13 – 2818:4. When Mr. von Glinow later asked more questions about the financial health of the Four Funds and whether he would get his money back, Mayer told him "[t]hese are private [placements]. We don't have to give you that kind of information. We are not required to give you that kind of information." Tr. 2826:23 – 2829:12. Mayer said this despite the Four Funds PPMs' promise to provide financial information (including a balance sheet and income statement) upon request. Tr. 3274:5-17; *see also, e.g.,* DE 5 at 21.

E. Philip Rabinovich

Rabinovich argues that he "went to extraordinary lengths to help his clients," did not misrepresent or omit material facts to his customers, and was not confronted with red flags warranting inquiry. Rabinovich Br. 1-3, 7-11. He further argues for a lenient standard that would require brokers to investigate products only when they "actively and knowingly participate in fraud." *Id.* at 2. Moreover, as the ALJ explained, Rabinovich's "testimony was often inconsistent or contradicted by other evidence." ID at 106. For example, despite claiming to be aware of how MS & Co. would use investor proceeds, Rabinovich never requested basic information despite his "continuous contacts with Smith," "financial help" he gave to Smith to close deals, and "his ability to obtain data to support Smith's representations about the private placements." ID at 106-07.

1. <u>Rabinovich Knowingly or Recklessly Recommended the Four Funds and Trusts</u>

Rabinovich seeks to have it both ways, claiming both that he conducted a meaningful investigation but that he never saw any sign of trouble. For example, in 2006, Rabinovich presented FIIN to his customers, which was, by that point, heavily invested in affiliates like alseT and a Pre-2003 Trust; had lent money to TDM Cable Funding LLC and FEIN; and was running a deficit during the 2006-boom economy. *See* DE 2 at 140-41 (FIIN balance sheet). If, as Rabinovich claims, he knew of some of FIIN's investments before recommending it to his customers three years after the offering commenced, *see* Rabinovich Br. 17, that knowledge bolsters the case against him, as it means he defrauded his customers knowingly, rather than recklessly. The "*independent* analysis" Rabinovich claims to have conducted, Rabinovich Br. 20 (emphasis in original), would have presented Rabinovich with similarly damning knowledge, though such analysis is belied by Rabinovich's failure to even ask for, let alone see, a balance sheet. *See* Tr. 1947:6 – 1948:2. Indeed, a true investigation and analysis would have forced Rabinovich to confront the Four Funds' many investments in affiliates and each other. DE 2 at 135-41.

Rabinovich also asserts that he relied on others to discharge his obligations. Rabinovich Br. 19-20. But the only "evidence" of due diligence by "investment banks on large portions" of the Four Funds investments is his own testimony and whatever due diligence others conducted did not relieve Rabinovich of his duties. Div. Jt. Resp. 17-19.

Rabinovich failed to investigate despite obvious red flags. *First*, Rabinovich was aware, or extremely reckless in not knowing, of the many red flags contained in the PPMs. For example, Rabinovich was aware of the Four Funds inherent conflicts of interest but nevertheless presented these investments to his clients without further inquiry. Tr. 1922:12 – 1925:22, 1929:21 – 1930:18. Dismissing these as "standard disclosures" does not absolve Rabinovich of his duty. Rabinovich Br. 7.

Rabinovich also knew the Four Funds could—and did— acquire investments from MS & Co. affiliates, but never asked basic questions about those investments. Although Rabinovich knew by 2006 that the Four Funds invested in alseT, he did not ask how much Four Funds money was invested until January 2008. Tr. 1949:8-22, 2057:20-24. He knew about Livingston's ownership interest in alseT and that it was a venture capital investment that "was certainly different than the mandate called for" in the Four Funds PPMs, but never asked questions. Tr. 1950:9-25; *see also id.* at 2033:21 – 2034:25. Rabinovich also knew that the Four Funds held a "large position in excess of $10 million in [Pre-2003] alarm contracts," but never asked how much the Four Funds paid for these assets. Tr. 1952:4-14, 4513:14 – 4514:10. This flag should have been particularly meaningful to Rabinovich, who was aware that MS & Co. used the IASG public offering to redeem investors in the Pre-2003 Trust Offerings. Tr. 1919:17-1920:15. At the very least, the consistent comingling undermines Rabinovich's claimed reliance on McGinn and Smith's "extensive and impressive experience" and their "extensive due diligence." *See* Rabinovich Br. 4.

Rabinovich was aware that the Four Funds PPMs limited sales to accredited investors only, Tr. 1993:14 – 1995:20, 1997:20 – 1999:12, but nevertheless sold these investments to unaccredited investors. DE 531-34. Rabinovich also sold certain Trust Offerings that charged extremely high fees, including Benchmark (35% fee) and TDM Verifier 07 (21% fee), among others, and Trusts created for the express purpose of redeeming other investors. *See* DE 2 at 117-21, 149-51.

Second, Rabinovich found Smith "reluctant to give out specific financial information" regarding the Four Funds. Tr. 1932:6 – 1934:25. This should have prompted him to ask more questions. Div. Jt. Resp. 21.

Third, Rabinovich's claim that he did not know about redemption issues is false. Rabinovich Br. 8. He testified that he knew about redemption issues and understood by December 2007 that no "new redemptions were taking place without [a new customer]." Tr. 2017:5-21; *see also* DE 2 at 119, 122-23; DE 614, 615, 17; Tr. 2019:14-25 (collectively showing Rabinovich TAIN customer redeemed via secondary sale); Tr. 1976:9-24, 1988:15 – 1989:10; DE 2 ¶¶ 43-44; DE 591, line 3681 (collectively showing Rabinovich Pre-2003 Trust customer redeemed with FEIN, TAIN, and FIIN investor funds and his failure to inquire). And Rabinovich received the December 2007 email from Guzzetti instructing the MS & Co. brokers to "make sure you replace any redemptions promptly." DE 19, Tr. 2010:25 – 2011:7.

Even more troubling, Rabinovich ensured his father was redeemed using new investor funds on a $600,000 "bridge loan" made in October 2007 in connection with Firstline. Tr. 2091:6 – 2093:6, 2098:14-21, 2100:4 – 2101:24, 2103:2 – 2104:10; DE 2 ¶ 89, 154; DE 547. No loan documentation was created: Rabinovich's father executed a subscription agreement and received interest payments like any other investor. Tr. 3409:17 – 3410:5, 2105:14 – 2106:6. Rabinovich was copied on an October 29, 2007 email from McGinn sent to MS & Co.'s bank, instructing it to wire $600,000 received from his father to various recipients, including an Albany-based clothier. DE 549. Rabinovich acknowledged that sending money raised from Firstline 07 Series B to the clothier was improper, but claims not to have read this email at the time. Tr. 2097:2-22. In order to redeem Rabinovich's father, MS & Co. brokers—including Rabinovich—made twenty sales of Firstline 07 Series B 11% between April 23, 2008 and June 16, 2008. DE 2 at

120, 154. Rabinovich was aware that new investor money was used to redeem his father. Tr. 2100:4 – 2101:24, 2103:2 – 2104:10. Moreover, Rabinovich earned commissions on his father's "loan" and on his own Firstline sales to redeem his father. Tr. 4501:20 – 4502:2, Tr. 4503:8-24, Tr. 4507:8-17, DE 2 at 122-23.

In January 2009, Rabinovich's father again made a $250,000 "loan" to TDMM Cable 09 and was redeemed via secondary sales. Tr. 2115:14 – 2117:7; DE 2 at 121. Rabinovich understood that in order for his father to be redeemed, the MS & Co. sales force would have to raise the balance of the $250,000 owed and "felt confident" that they could do this. Tr. 2116:18-22. Rabinovich pushed Guzzetti to ask the sales force to sell TDMM Cable 09 to redeem his father. DE 70, 71, Tr. 2118:13 – 2121:25. In September 2009, Rabinovich bought a $25,000 TDM Verifier 11 certificate himself for the express purpose of redeeming another broker's customer (and was paid a commission on his own purchase). DE 646-48, Tr. 4494:12-21, 4499:15-18; DE 2 at 121; *see also* Tr. 4491:13 – 4492:14.

Fourth, Rabinovich knew of many of MS & Co.'s mounting troubles as he continued to sell products backed by McGinn and Smith. His dismissal of the January 8, 2008 meeting as "unsurprising," Rabinovich Br. 8-9, fails for the same reason Mayer's argument does. Rabinovich heard and understood McGinn's instruction to "drive revenues to the funds" by "pump[ing] out the swamp." Tr. 2065:19 – 2069:9, 2076:23 – 2077:17. By the second or third quarter of 2009, Rabinovich knew the firm was in serious financial trouble. Tr. 2125:2-23. By the time of the August 2009 Benchmark offering, Rabinovich already knew that MS & Co. was at risk of a net capital violation. Tr. 2127:6 – 2128:11. Still, Rabinovich accepted customer funds for a Benchmark purchase on September 15 and 21, 2009, DE 2 at 121—even after learning of the Firstline bankruptcy, Tr. 2139:24 – 2141:9, 2148:9-15—incredibly arguing that his bosses' concealment of the Firstline bankruptcy had no bearing on his evaluation of the Benchmark securities offered by the very same people (notwithstanding its exorbitant fees). Tr. 2146:19 – 2147:8

2. Rabinovich Made Material Misrepresentations and Omissions

The record is replete with Rabinovich misrepresentations and omissions. In July 2004, Rabinovich emailed an investor that FEIN was "performing extremely well." DE 43. At best, Rabinovich had no knowledge of FEIN's performance. The FEIN LLC had been in existence for seven months and had made only one interest payment to investors. DE 6 at 1. That certain defrauded investors testified on Rabinovich's behalf, Rabinovich Br. 9-10, 22-23—including an investor with close ties to Rabinovich's family, Tr. 4366:16-20—does not alter the nature of Rabinovich's misconduct.

In 2005, Rabinovich repeatedly described the Four Funds to investors as an asset with "substantial cash flow, a history of performance and limited liquidity in the market place," even though this language was recycled from a letter Smith drafted, RMR Ex. 22, to describe another fund (which was never created) and Rabinovich had done no investigation into the Four Funds cash flow and performance. Tr. 1960:14 – 1964:7, 1971:24 – 1972:17, 1966:25 – 1967:22; DE 15, 35, 40, 42. He misrepresented to [redacted] Chapman—a FEIN investor who testified at the hearing—that the FEIN notes were "safe bonds," leading her to believe that they were "high-grade bonds." Tr. 2182:5 – 2182:22, 2187:4-8; DE 2 at 117. Despite telling Rabinovich that she had "very little tolerance for risk," *see* Tr. 2186:10-23, Rabinovich sold Ms. Chapman the riskiest tranche of FEIN—the 10.25% note—*without* disclosing to her that there were different tranches of FEIN with different levels of risk, Tr. 2187:16 – 2187:25, or reviewing with her the significant risks disclosed in the FEIN subscription agreement. Tr. 2222:11-24, RMR 825.

Rabinovich also defrauded [redacted] Patel, [redacted]. Dr. Patel invested $45,000 in three MS & Co. offerings, all between March 2008 (after Rabinovich attended the January 8, 2008 meeting) and August 2009 (after Rabinovich knew about the net capital violation). Tr. 148:25 – 149:10, 158:25 – 159:22; DE 2 at 120-21. Dr. Patel told Rabinovich that he was concerned about the stock market and wanted safe investments. Tr. 169:20 – 170:3, 180:24 – 181:7. Based on information from Rabinovich and Smith, he believed that his MS & Co. investments were safe. Tr. 155:4 – 155:11, 181:15 – 182:5, 151:25 – 152:12. Dr. Patel did not read or understand the subscription agreements and purchaser questionnaires that he signed: he "completely trusted" Rabinovich and "just sign[ed] and sen[t] [the documents] back." Tr. 155:20 – 156:4; *see also id.* at 191:5 – 192:4. Rabinovich never cautioned Dr. Patel that he risked losing his money, never disclosed that MS & Co. had redemption issues, and never provided any information from the January 8, 2008 meeting, including that the Four Funds had been restructured due to significant investment portfolio impairments and that McGinn urged brokers to drive revenue to MS & Co. to bail out Four Funds investors. Tr. 164:11 – 164:17, 165:24 – 166:12. With respect to TDM Verifier 07R, Rabinovich never told Dr. Patel that his investment was for the specific purpose of redeeming other investors. Tr. 161:16 – 162:11. When Dr. Patel invested in Benchmark on August 31, 2009, Rabinovich never told Dr. Patel that MS & Co. was at risk of a net capital violation, and that Smith and McGinn had asked Rabinovich, along with Mayer and another broker, for a capital infusion into the firm. Tr. 165:12 – 165:23.

II. <u>Guzzetti Failed Reasonably to Supervise</u>

As a supervisor, Guzzetti was required to act decisively to investigate any indications of irregularity. Guzzetti, however, never made any inquiries during his years at MS & Co. When asked at the hearing whether he ever saw anything suspicious at MS & Co., Guzzetti said "absolutely not." Tr. 3148:24-3149:8; *see also* ID at 111 ("In five years, Guzzetti did not send any emails or conduct any sessions urging investigation, care or understanding of the product by the registered representatives that he supervised[.]").

Guzzetti does not deny that he was a supervisor during the massive fraud. His defense hinges on establishing that his supervisory role excluded the Four Funds and Trusts. Guzzetti Br. 8 ("Guzzetti was ***A*** supervisor, not ***THE*** supervisor when it came to the offerings at issue") (emphasis in original). The evidence shows that the Four Funds and Trust Offerings were Guzzetti's primary focus at MS & Co., and that Guzzetti acted as Smith's and McGinn's right-hand man in administering and encouraging Four Funds and Trusts sales.

A. The Evidence Proves Guzzetti's Supervisory Role Over the Selling Respondents and the Four Funds and Trust Offerings

Guzzetti's Brief makes six arguments: (1) the ALJ ignored certain witness testimony; (2) the Compliance Manuals do not identify him as the supervisor for the Four Funds and Trust Offerings; (3) the Branch Office Procedures manual was never in effect; (4) the "laundry list of facts" in the ID do not show his supervision; (5) the Redemption Policy did not exist; and (6) his emails to the sales staff do not show supervisory responsibilities.

Each of these arguments fails. The evidence conclusively demonstrates that "Guzzetti played a major managerial and authoritative role at MS & Co." and that "he had the requisite degree of responsibility, ability and authority to affect the Selling Respondents' conduct." ID at 110.

First, Guzzetti claims that the ID "overlooked, discounted or ignored" several witnesses' testimony. Guzzetti Br. 7-8. Guzzetti points to Lex and Mayer's hearing testimony that he was not their supervisor, Guzzetti Br. 7-8, but this testimony was not credible. ID at 103, 105 (both Lex and Mayer's credibility was "highly suspect"). The 2007 and 2008 Compliance Manuals state that Guzzetti was "directly responsible for all outside RRs," Guzzetti Ex. 2 at 37; DE 329 at 40, and Guzzetti testified that Lex was one of the "outside RRs" that he supervised. Tr. 2981:5-10. Moreover, Lex testified to the contrary to FINRA in 2009: "[f]or sales, I speak to Steven [Smith], or David Smith, Timothy McGinn, Andy Guzzetti." Mayer's testimony was also contradictory: "I was always under Dave Smith, but then Andy Guzzetti arrived in approximately 2004 and I was under Andy Guzzetti . . . [After 2004], [i]t was more reporting to Andy. [T]he operational things were under Andy." Tr. 3258:15-3259:4.

Gamello, who worked out of the Clifton Park office, where Guzzetti was appointed Branch Manager in October 2008, testified that Guzzetti was always one of his supervisors and that Guzzetti was "who I would go to for questions on anything." Tr. 1736:24-1738:16; *see also* Tr. 2684:12-18 (Chiappone: Guzzetti had the authority to tell him what he could and could not do); Tr. 3675: 8-19 (Rogers identifying Guzzetti as a supervisor).

Guzzetti did not identify any evidence to support his claim that he was somehow walled off from supervising the Four Funds and Trusts. *See* Tr. 2975:14-24, 2971:4-9 (Guzzetti: nobody told him that his supervisory duties did not cover the Four Funds and Trusts), 2976:17-2977:10 (no documents saying Guzzetti did not have supervisory responsibilities for McGinn Smith Securities).

Guzzetti's own testimony was inconsistent. In his 2011 grand jury testimony, Guzzetti testified that "all the retail sales force reported to me when it came to products and prospecting for new business and things like that." Tr. 2964:2-2965:10. And in his 2011 deposition, Guzzetti testified that he *did* supervise brokers who sold the Four Funds. *Id.* at 2968:2-13, *see also id.* at 2966:24-2968:15 (Guzzetti: "everything came through me to go to the brokers as far as . . . products. We did a lot of compliance work in our sales meetings.")

Guzzetti also argues that the ID ignored the testimony of his expert Kevin Carreno. Guzzetti Br. 8-9. Guzzetti emphasizes Carreno's opinion that Guzzetti was a mere "sales manager . . . [which] is not a supervisory role" in the brokerage industry. *Id.* at 8. Carreno's opinion, however, is unreliable because Carreno did not review *any* of the critical evidence of Guzzetti's conduct, including underlying exhibits, and based his opinion on discussions with Guzzetti and his counsel. Tr. 4798:21-4800:24. Given that much of Guzzetti's conduct is reflected largely in numerous emails sent and received from 2004 to 2009, Carreno's failure to review any of these emails diminishes his conclusions' credibility.

Carreno also opined that Guzzetti's conduct conformed to applicable standards, and that Guzzetti was justified in accepting, without any further inquiry, Smith's explanation that problems were attributable solely by the 2008 financial crisis. Tr. 4821:24-4822:6; 4819:5-8. This opinion should be rejected because it contradicts long-established principles that "the federal securities laws require a vigorous response even to indications of wrongdoing." *See Ronald S. Bloomfield, et al.*, Rel. 9553, 2014 WL 768828, at *11 (Feb. 27, 2014).

Second, Guzzetti cites MS & Co.'s Compliance Manuals to argue he had no supervisory authority over the Four Funds and Trust Offerings. Guzzetti Br. 9-12. The Compliance Manuals, however, say nothing regarding Four Funds and Trusts supervision. They do, however, identify Guzzetti as a top MS & Co. supervisor, namely "Supervisory Personnel . . . [who is] responsible for the supervisory activities of the firm" (both 2007 and 2008); and note that all Clifton Park brokers "are under Andy Guzzetti's direct supervision" (2008 only) and Guzzetti was "directly responsible for all outside RRs" (both 2007 and 2008). Guzzetti Ex. 2 at 45, 37; DE 329 at 40, 47-48.

Guzzetti emphasizes that the Compliance Manuals require subscriptions to MS & Co. private placements to "be reviewed and accepted by a principal of the firm," Guzzetti Ex. 2 at 42, DE 329 at 44, and notes that "[his] name does not appear at all in this section." Guzzetti Br. 11. This section, however, does not identify, by name or by position, anyone with supervisory authority over the Four Funds and Trust Offerings. *Id.*

Third, Guzzetti incorrectly discounts MS & Co.'s Branch Offices Procedures ("BOP") manual as "never authenticated and never identified." Guzzetti Br. 12. Guzzetti *agreed* to the admission of the BOP without objection, including authenticity. Tr. 9:5-7; 371:22 - 373:7. He has waived, therefore, any authenticity objection. *See McGonigle v. Combs*, 968 F.2d 810, 825 (9th Cir. 1992) (failure to object to authenticity waives objection); *In re Worldcom*, 357 B.R. 223, 228-29 (S.D.N.Y 2006) (similar). When shown the BOP manual, moreover, Guzzetti did not dispute its authenticity and testified that he "may have" seen it before. *See* Tr. 3005:17-20.

Guzzetti is wrong that "[t]he record is devoid of any evidence as to . . . when [the BOP manual] was created, if it was ever used, and if it was used, when it was used." Guzzetti Br. 12. The BOP Manual, although undated, was in effect during Guzzetti's MS & Co tenure. Specifically, the manual refers to NFS, DE 328 at 13, 14, and Guzzetti himself was instrumental in selecting NFS as MS & Co.'s clearing firm in 2005 and remained at the firm when NFS terminated this relationship in September 2009. Tr. 2962:14-21, 4654:4-8.

The BOP manual provides further evidence of Guzzetti's supervisory authority. It makes clear that, as Clifton Park branch manager, Guzzetti had a responsibly, among other things, to "[e]nsure that . . . no unusual sales practice activities are occurring in connection with the review of daily trading." DE 328 at 13. Guzzetti plainly did no such thing, showing yet again Guzzetti's failure to conform to even minimal supervisory standards.

Fourth, Guzzetti dismisses the "laundry list of facts" in the ID and argues that these "alleged 'facts' . . . have no relation to whether Guzzetti had the responsibility, ability or authority to affect the conduct of [the Selling Respondents]." Guzzetti Br. 15-16. The ID properly considered the facts and circumstances of Guzzetti's duties and conduct at MS & Co. because Guzzetti's "'actual responsibilities and authority . . . will determine whether he . . . is a 'supervisor' for purposes of [Exchange Act] Sections 15(b)(4)(E) and (6).'" ID at 110 (quoting *Bloomfield*, 2014 WL 768828, at *11).[10]

Guzzetti fails to explain why the facts have "no relation" to supervision. These facts – including Guzzetti's roles in hiring, recruiting, determining compensation, conducting weekly sales calls, attending FINRA exit conferences, selecting a clearing firm – are quintessential supervisory functions. They prove that Guzzetti's actual responsibility and authority make him a supervisor and that the private placements were not walled off from his supervision.

In 2008 and 2009, Guzzetti received numerous emails that demanded some kind of inquiry. Addendum A; DE 127. For example, he knew that Lex believed that "the fiduciary responsibility to the clients has been breached;" that the Rabinovich "loan" to Firstline was repaid with new investor funds; that interest payments were not being paid; and that Lex's clients were asking "if they've bought into a Ponzi scheme." DE 161, 547, 20. Guzzetti never inquired into any of these issues, and instead continued to urge brokers to "make the calls." This conduct proves not only Guzzetti's serious failure as a supervisor, but his actual involvement and

[10] Guzzetti also argues that leading supervision cases (ID at 110) – *Gutfreund*, *Bloomfield* and *Kolar* – are "distinguishable" because in those cases the Respondent was found to be a supervisor, and Guzzetti insists he was not. Guzzetti Br. 13-15. As shown by voluminous evidence at the hearing, however, and as summarized in the ID, the facts overwhelmingly show that Guzzetti was Selling Respondents' supervisor with regard to their sales of the Four Funds and Trusts. Moreover, Guzzetti's conduct was in many ways even more egregious than the conduct in *Gutfreund*, *Bloomfield* and *Kolar* because Guzzetti's supervisory failures occurred over five years and contributed to massive investor losses.

knowledge of the fraud. *See also* Tr. 2969:22-2970:7 (Guzzetti's Answer: "Mr. Guzzetti admits that after October 2006, he was a supervisor for some of the MS & Co. brokers for their general securities activities[.]").

During his weekly sales meetings, Guzzetti gave brokers instructions on selling private placements, specifically, emphasizing "my three big ones": "make sure accredited," "[n]o cold calling and make sure you sell off the PPM." Tr. 3000:11-3002:10; *see also* DE 90; Tr. 3072:12-3074:5 (agenda for 12/17/07 "4:11" conference call).

Numerous emails sent and received by Guzzetti also demonstrate his supervision over Four Funds and Trusts sales. For example, in a 2006 email to an MS & Co. investment banker, Guzzetti said:

> As discussed in many of my Tuesday AM meetings there are many investors sitting in money market accounts (fear of higher interest rates) who are losing return (cost of waiting). Our FAIN's offer a way of locking in higher returns with $ sitting in money markets waiting for the 'top' in interest rates. I would never suggest that we take $ that have to stay liquid (true money market $) and put them in an investment that is tied up for a longer term with higher risk. . . . DON'T EVER QUESTION ME ABOUT MY KNOWLEDGE OF THE RETAIL BROKERAGE BUSINESS.

DE 141; Tr. 3028:3-3030:19; *see also* Addendum B.

Fifth, Guzzetti dismisses the relevance of the many emails he sent and received regarding redemption requests for maturing Four Funds and Trust notes, and his critical role implementing Smith's desire that brokers needed to "replace" maturing notes with new investments. Guzzetti first learned of the need to pay old investors with incoming funds in December 2006, when Smith emailed him that "I am running on fumes with all these redemptions and cannot afford any more." DE 17. In a November 10, 2007 email, Smith gave Guzzetti specific instructions: "Any redemptions have to have replacement sales beforehand . . . My preference is for there to be no redemptions." DE 119. Guzzetti testified that, during a November 12, 2007 conference call, he "explained [to the brokers] what [Smith told me in that email [DE 119]." Tr. 3057:15-3058:23. During 2007 and 2008, Guzzetti sent and received numerous emails carrying out Smith's redemption instruction. Addendum A. Many of these emails contained tables comparing the "Amt to Redeem" with "New Tickets" and "Left to Sell" for Lex, Feldmann, Gamello, Chiappone and Mayer. DE 279; Tr. 3063:3-3065:2.

Guzzetti was involved in decisions about which Four Funds and Trust customers got redeemed. In January 2008, he emailed Smith that "we may want to redeem" a customer because "I don't want to get a letter from their lawyers." DE 127. And in April 2009, Smith, who was deciding which of two customers should be redeemed, asked Guzzetti "[w]hich squeaky wheel should we take care of?" Guzzetti responded by naming his preference and also giving his reason: "only because he can do other deals." DE 77.

Sixth, Guzzetti's argument that his emails to MS & Co. brokers "are not evidence of supervisory responsibilities" is wrong. Guzzetti Br. 18. His emails and weekly broker conference calls, which were opportunities to show his leadership in connection with the private placements and to satisfy Smith, evidence supervision. *See* Addendum B; Tr. 2990 at10-25-2991:2 (Guzzetti: "[Smith] liked the idea of my sales meetings. I know he liked the idea of my morning notes every day. He thought they were great.").

Guzzetti's argument that his emails "were not an attempt to push MS & Co. proprietary products," Guzzetti Br. 19, is contradicted explicitly by the emails. *See* Addendum B. Using all capital letters for emphasis, Guzzetti strongly encouraged brokers to recommend McGinn Smith Securities to their customers and to move customer funds from money markets to MS & Co. private placements. Indeed, Guzzetti actually calculated the amount customers had in money market funds for this purpose. Tr. 3025: 3-20. Troublingly, Guzzetti continued to push MS & Co. deals *after* learning that he and the brokers had been lied to about the Firstline bankruptcy. DE 143, 144; Tr. 3193:22-3194, 3202:15-3203:20.

B. The OIP Properly Requested Sanctions Under Section 15(b) of the Exchange Act

Guzzetti argues that "the Division did not request a suspension or bar for Guzzetti in the [OIP] or its opening statement (its prehearing brief)" and, as a result, "all charges against Guzzetti should be dismissed." Guzzetti Br. 4.

The OIP, as in all APs, does not set forth the specific relief sought. Instead, it states that the hearing will determine what remedial action against Guzzetti is appropriate "pursuant to Section 15(b) of the Exchange Act." Section 15(b), among other things, authorizes the Commission to bar or suspend a person from association with a broker-dealer "if it finds that such person failed reasonably to supervise[.]"

The Division's Prehearing Brief argued that Guzzetti failed reasonably to supervise the Selling Respondents with a view to preventing and detecting violations. Jan. 17, 2014 Div. Prehearing Mem. 19. It also argued the Court should impose meaningful sanctions and other remedies against Respondents, including Guzzetti, and ensure that they "are prevented from future violations victimizing the investing public, and are punished for violating the securities laws." *Id.* at 20. Guzzetti learned *before the hearing* that the Prehearing Brief's omission of specific requests for relief against him was unintentional. *See* Jan. 21, 2014 Conf. Tr. at 37:6-8.

Guzzetti does not claim any prejudice, and does not argue that his ability to defend himself was in any way compromised. In *Horning v. SEC*, 570 F.3d 337 (D.C. Cir. 2009), the Division, *after* completing its case in chief, "changed the relief it requested to a bar from all supervisory positions." *Id.* at 347. The D.C. Circuit nevertheless held that the respondent was not prejudiced or deprived of his procedural due process rights, or of appropriate notice and opportunity for a hearing, because the respondent "had notice from the outset of the nature of the charges against him." *Id.* Guzzetti's waiver argument should be rejected.[11]

III. Respondents Should Face Meaningful Sanctions

A. The Commission Should Order Disgorgement and Prejudgment Interest Against Selling Respondents

Disgorgement "deprive[s] wrongdoers of their unjust enrichment and deter[s] others from similar misconduct." *Bloomfield*, 2014 WL 768828, at *20. Disgorgement is appropriate whether those gains were obtained due to fraud or sales that were unlawful for some other reason. *Id.*, at *20-21 (awarding disgorgement of commissions earned on sales in violation of Section 5). A proper measure of Respondents' unjust enrichment is the commissions paid to each Respondent for his respective unlawful sales. *See Kenneth R. Ward*, Rel. No. 8210, 2003 WL 1447865, at *14 (Mar. 19, 2003). Respondents received the following commissions on their sales: Chiappone: $531,844; Lex: $1,775,544; Livingston: $143,879; Mayer: $122,455; and Rabinovich: $586,741. DE 2 at 48. The Division respectfully urges the Commission to deprive them of these ill-gotten gains, with prejudgment interest thereon.

B. Respondents Should Be Required to Pay Substantial Penalties

The Division seeks third-tier civil monetary penalties for each of Respondents' violations of the securities laws since September 23, 2008, five years prior to the filing of the OIP. Third-tier penalties are appropriate where Respondents' conduct reflects such a state of mind <u>and</u> the conduct in question directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons, or resulted in substantial pecuniary gain to the person

---

[11] Guzzetti's sole authority is not remotely relevant: *U.S. v. McKeon*, 738 F.2d 26 (2d Cir. 1984) considered "the evidentiary use of prior jury argument." 738 F.2d at 32.

who committed the act or omission. 15 U.S.C. § 78u-2(c). Courts should look at six factors to determine whether civil monetary penalties are in the public interest: (1) deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. 15 U.S.C. § 78u-2(c).

As discussed above, Respondents' conduct was deceptive over a long period of time, caused significant investor losses, and allowed Respondents to unjustly enrich themselves. The Division does not seek punitive sanctions addressing pre-September 23, 2008 misconduct, but such "prior violations," such as Respondents' pre-September 23, 2008 sales described herein, add weight to the case for sanctions to promote the public interest. *See* Div. Jt. Resp. 5-6. Mayer and Lex's disciplinary history also supports a significant sanction. DE 484 at 15; DE 482 at 12-13. Finally, significant civil penalties will deter other brokers from neglecting their duties to customers.

C. Respondents Should Be Barred from the Securities Industry

Whether a bar is in the public interest depends on "the egregiousness of the respondents' conduct; the isolated or recurrent nature of the infraction; the degree of scienter involved; the respondents' recognition of the wrongful nature of their conduct; the sincerity of any assurances against future violations; and the likelihood that the respondents' occupations will present opportunities for future violations." *See Bloomfield*, 2014 WL 768828, at *18 (citations omitted); *see also Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979).

For Guzzetti, Section 15(b) of the Exchange Act authorizes the Commission to impose a broad associational bar or suspension against any person "if it finds that such person failed reasonably to supervise, with a view to preventing violations of the federal securities laws, another person who commits such violations, if the other person is subject to the person's supervision, and if it is in the public interest." *Angelica Aguilera*, Rel. No. 501, 2013 WL 3936214, at *25 (July 31, 2013) (citations omitted). Whether such a sanction is in the public interest turns on the same *Steadman* factors discussed in the ID. *Id. See Bloomfield*, 2014 WL 768828, at *19. Moreover, the Commission has held "[s]upervisors are the first line of defense against wrongdoing by their subordinates." *Id.* As such, "failures to supervise are serious violations." *Id.*

As discussed above, Respondents committed egregious securities laws violations spanning years. Moreover, Respondents refuse to take responsibility for their actions. With the exception of Lex, all remain in the industry and, unless barred, are threats to repeat violations. *See Ward*, 2003 WL 1447865, at *13 (barring even broker not working in the securities industry for eight years but who indicated a desire to return).

D. Cease and Desist Orders Are Warranted Against Selling Respondents

In determining whether a cease-and-desist order is appropriate, the Commission considers the *Steadman* factors. *See Bloomfield*, 2014 WL 768828, at *19. A single violation ordinarily suffices to establish a risk of future violations. *Id.* Here, Respondents committed egregious violations and cease-and-desist orders will have a beneficial deterrent effect to prevent them from committing future violations. *See Timbervest, LLC, et al.*, Investment Advisors Act Rel. No. 4197, 2015 WL 5472520, at *17 (Sept. 17, 2015).

CONCLUSION

For the reasons set forth herein, Respondents' Petition should be denied.

Dated: New York, NY
September 30, 2015

Respectfully submitted,

DIVISION OF ENFORCEMENT

David Stoelting
Haimavathi V. Marlier
Michael D. Birnbaum
Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281
(212) 336-0174 (Stoelting)
(212) 336-1055 (Marlier)
(212) 336-0523 (Birnbaum)

Addendum A
Emails Regarding Redemptions

DATE	DESCRIPTION	DIV. EX.
11/14/2006	Sicluna to Guzzetti: "Andy, Lex is going to replace all of his clients that are redeeming. We need to know what Frank, Phil, Brian and Dick are going to do."	155
11/14/2006	Guzzetti to Mayer, Chiappone, Feldmann and Rabinovich: "WE HAVE TO KNOW ASAP WHAT YOUR CLIENTS ARE GOING TO DO WITH THE MATURING NOTES . . . ARE THEY GOING TO REDEEM OR ROLL"	16
12/21/2006	Smith to Sicluna, fw. Guzzetti: "Phil needs to replace the $100,000 before doing the trade. I am running on fumes with all of these redemptions and cannot afford any more. Please inform Andy."	17
02/02/2007	Guzzetti fw to Smith: "We do not have the funds ava unless you have cks/pmts that come in today's mail, we would need about 125K to come in to cover this request."	118
11/07/2007	Guzzetti to Feldmann: "As we discussed on numerous calls. Dave has asked that you replace all redemption $'s with new money. Thus my e-mail about replacements."	18
11/10/2007	Smith to Guzzetti: "I want it clear to all brokers that is not permissible. With the interest payment coming due and commissions payable in December I do not have the liquidity. Any redemptions have to have replacement sales before hand. . . . My preference is for there to be no redemptions. . . . Please handle this with TLC. We need some team play and cooperation."	119
11/12/2007	Guzzetti to Smith: "Call went well. Not a lot of discussion. I am not sure they believe us about redemptions. I have a feeling they are thinking if push comes to shove we have to redeem."	120
11/14/2007	Sicluna to Guzzetti: "Bill Lex has new tickets for all of his redemptions" but that she had not "received any replacements, total is $432,000, from the other brokers." A table listed compared the "Amt to Redeem" with "New Tickets" and "Left to Sell" for Lex, Feldmann, Gamello, Chiappone and Mayer.	279
11/15/2007	Guzzetti to Chiappone: "Frank Your clients have redeemed $45,000 of the 1 yr FAIN. We have not received any replacement tickets. Please advise."	242
11/15/2007	Guzzetti to Gamello: "Bill Your clients have redeemed $100,000 of the 1 yr FAIN and we have not received any replacement tickets. Please advise."	181
11/16/2007	Gamello to Guzzetti: "I don't really have replacement at	182

	this time . . . for the future I'll look to have replacement set up."	
12/12/2007	Sicluna to Smith, Guzzetti and McGinn: "Bill Lex has stressed that some of his redemptions for TAIN and FIIN must be done on 12/15/07 and that others can wait until 1/1/08 or 1/15/08." List of amounts of the redemption requests and the amount of "replacement tickets" submitted by Lex.	122
12/19/2007	Guzzetti to Smith, Sicluna and Rees: "Bill Lex is very concerned and upset about clients not being paid upon redemption of notes. . . BILL HAS $865,000 IN REDEMPTIONS HAS TICKETED $390,000 IN REPLACEMENTS . . . FIIN 7%: BILL HAS $385,000 IN REDEMPTIONS HAS NOT TICKETED ANY REPLACEMENTS..."	160
12/19/2007	Guzzetti to Sicluna: "WARNING....Bill Lex will be calling you in a few minutes... wants to go over priority redemptions.... call me when you get a chance."	123
12/19/2007	Gamello to Guzzetti: "Andy, I have a client...that redeemed 30,000 in a FAIN note on NOV. 15th, I wrote a replacement ticket but he has still not been cashed out of the note, when will he be cashed out?"	183
	Guzzetti to Sicluna: "Has money come in. If it has we should redeem. Please advise." Sicluna responded that "Bill has replaced them, money has been received but ... [t]he redemption is suppose to go to Firstline."	
12/19/2007	Guzzetti to Smith: "Please okay the redemption of this client. FC Gamello replaced the money."	282
12/20/2007	Sicluna to Guzzetti: "Andy, FYI – Breakdown by broker FINN, TAIN and FAIN Redemption and New Tickets," which summarized the "Amt. to Redeem," "New Tickets" and "Left to Sell" for Lex, Chiappone and Mayer.	125
12/20/2007	Sicluna to Guzzetti re TAIN 7% note stating: "Please redeem the following. Don Anthony and Frank have both replaced the redemption and funds were collected for the replacement."	283
01/16/2008	Guzzetti to Anthony: "Sorry for not getting the answer sooner, but I wanted to connect with Dave Smith. Dave is not changing his position....if a client wants to redeem out of a 1 yr piece of paper. We must have the fc [financial consultant] replace it."	262
01/16/2008	Sicluna to Guzzetti, Gamello: "Martino's $30,000 FAIN 7% note was redeemed today . . . Pending Firstline purchase will be done tomorrow."	187
01/29/2008	Sicluna to Smith, Guzzetti: summarizing the redemptions	500

	for FEIN 7% for Lex, Chiappone and Rabinovich, listing total redemption requests, total redeemed, the amount to be collected from new tickets, and the amount left to sell.	
05/05/2008	Lex to Guzzetti: "With the money that comes in, will I be redeemed for any of my 1-Yr, FIIN and/or TAIN?"	163
01/05/2009	Guzzetti to Cooper: "I AM GETTING QUESTIONS ABOUT DEALS NOT GETTING PAID INTEREST PAYMENTS THIS MONTH. PLEASE ADVISE."	136
01/05/2009	Lex to McGinn, Smith and Guzzettii: "I don't recall ever getting the interest and the principal on the due date. I'm not concerned with my own account, but this raises a credibility problem with our clients and raises doubts about the efficiency of our operation. Also, it creates needless client calls that become a distraction and take time away from new sales."	137
01/06/2009	Lex to McGinn, Smith and Guzzettii: "It is disturbing that it will be January 6th before people receive their money. I had three calls Monday and expect more calls today. It is tough making excuses for the inexcusable! It is getting harder to make repeat sales to clients that are skeptical and unnerved. Can you assure the FC that their clients will start receiving interest payments on time? January 15th and January 30th are the next quarterly due dates for the notes. Help!"	137
03/17/2009	Lex to Guzzetti, McGinn and Smith: "When the TDM was given to the sales force to sell about 20 months ago, we were not told that investors could only redeem if a new client took them out. My clients continue to ask me if they've bought into a Ponzi Scheme and I've tried to reassure them that that is not the case. This current situation is not helping me build confidence with clients who have hundreds of thousands of dollars in McGinn, Smith investments."	20
04/21/2009	Sicluna to Guzzetti and Smith: "Total yet to be redeemed $500,000"	77
04/21/2009	Smith to Guzzetti: "Geoff is collecting $30,000 tomorrow. Which squeekey wheel shoiuld we take care of?"	77
06/02/2009	Lex to Guzzetti: "It's June 2nd. Where are the June 1st Firstline payments? Are there other first of the month payments not being distributed promptly? Please advise."	138
09/08/2009	Lex to Smith, McGinn and Guzzetti: "WHERE ARE THE PAYMENTS? Please advise specifically when people can expect payments via ACH, in their NFS accounts and in the mail."	98

11/23/2009	Guzzetti to McGinn, Smith: "Client is very antsy and wants answers before they proceed to the next step. Any chance of a redemption (requested in June)? Please advise."	248
11/23/2009	Smith to Guzzetti: "Andy, Brokers are asked to replace clients seeking redemption."	248

ADDENDUM B
Andrew Guzzetti's Morning Emails to MS & Co. Sales Staff

DATE	GUZZETTI'S STATEMENT	DIV. EX.
02/02/2006	what is left in FAIN . . . WE HAVE $24,000,000 IN MONEY MARKET ACCOUNTS. GET ON THE PHONE AND SHOW THE FAINS. 1 YR 6% 3 YR 7.74% 5 YR 10.25% TAKE A LOOK – MAKE THE CALL.	83
02/22/2006	OUR CLIENTS HAVE $24,000,000 IN MONEY MARKET ACCOUNTS. THEY SHOULD BE LOOKING AT FAINS. . . . TAKE A LOOK – MAKE THE CALL.	84
03/08/2007	CONGRATULATIONS TO THE FOLLOWING FC'S WHO QUALIFIED FOR DIRECTORS COUNCIL: BILL LEX (LEADER IN FEE BASED ASSETS AND NET NEW ASSETS)...FRANK CHIAPPONE...PHIL RABINOVICH...DICK FELDMAN...BILL GAMELLO (LEADER IN NEW ACCOUNTS)	255
06/26/2007	CALL EVERY CLIENT WHO HAS DONE ONE OF OUR PRIVATES AND ASK . . . 'WHO DO YOU KNOW, LIKE YOURSELF A SERIOUS INVESTOR, WHO IS LOOKING FOR ABOVE MARKET FIXED RATE OF RETURN WITH NO CORRELATION TO THIS SHAKY STOCK MARKET...' MAKE THE CALL.	111
11/14/2007	WE WILL BE SENDING OUT A LETTER TO ALL CLIENTS WHO WILL BE CHARGED THE $35.00 INACTIVITY FEE. LETTER ATTACHED. PLEASE CLEAN UP YOUR ACCOUNTS NOW.	129
11/16/2007	CMS FINANCIAL...GET THIS OPPORTUNITY IN FRONT OF YOUR CLIENTS.	650
11/28/2007	IF THEY [CLIENTS] ARE QUALIFIED INVESTORS SHOW THEM THE FAIN 7% ONE YEAR IF THEY CAN TIE THE MONEY UP FOR ONE YEAR . . . **MAKE THE CALLS.**	130
12/07/2007	WE HAVE A 1YR & 3YR TAIN, AND A 1YR FIIN ROLLING 12/15 PLEASE MAKE SURE YOU REPLACE ANY REDEMPTIONS PROMPTLY	19
01/16/2008	IF YOU NEED TO GET CLEAR ON REDEMPTIONS OF 1 AND 3 YR NOTES, PLEASE GIVE ME A CALL.	133
01/22/2008	BECAUSE OF REDEMPTION PROBLEMS OF NOTES, WE MAY HAVE SOME AVAILBILITY COMING IN THE 10%.	127
02/04/2008	CONGRATULATIONS TO EVERYONE FOR A GREAT 2007 UNDER SOME "TRYING TIMES" REMEMBER...JUST LIKE THE PATRIOTS...YOU ARE ONLY AS GOOD AS YOUR LAST GAME (CALL),,, MAKE THE CALLS	4
02/05/2008	IF YOU BELIEVE OUR FORMULA FOR SUCCESS (IF YOU DON'T YOU DON'T BELONG IN THE BUSINESS)...YOU MUST PROSPECT FOR NEW ASSETS...OR YOU CAN NOT	110

	SURVIVE IN THIS BUSINESS....FIND A WAY...MAKE THE CALLS	
05/27/2008	LET'S FINISH UP THE FIRSTLINE 11%.	378
10/09/2008	DAVE SMITH WILL BE ON A CALL TO DISCUSS THE RESTRUCTING PLAN FOR OUR NOTES. I HAVE ATTACHED A SUMMARY OF THE PLAN. THIS PLAN ALONG WITH A LETTER WILL BE GOING OUT TO CLIENTS ON MONDAY. ..I HAVE ALSO ATTACHED THE PREVIOUS 2 LETTERS THAT CLIENTS HAVE RECEIVED JUST TO HAVE IN FRONT OF YOU WHEN DAVE DISCUSSES THE PLAN.	263
01/16/2009	TDMM CABLE NEW DEAL.... THIS IS A GREAT CALL TO QUALIFIED INVESTORS ON MONDAY WHEN EVERYONE ELSE IS ON VACATION. OUR GOAL IS TO CLOSE THE DEAL BY END OF JANUARY.	393
02/17/2009	Attaching TALKING POINTS FOR TDMM CABLE; americanfunds	147
04/08/2009	Letter to Investors FIIN; Letter to Investors TAIN	26
07/27/2009	ESTABLISHED CLIENTS ARE NOT INVESTING OR NOT BEING CONTACTED.......WE STILL HAVE $34MIL IN MONEY MARKET FUNDS...THIS SAYS WE ARE USING MOSTLY NEW ASSETS TO INVEST.....WE NEED TO PROSPECT FOR NEW ASSETS, BUT WE CAN NOT IGNORE OUR EXISTING CLIENT BASE...... AT THE TIME OF THE INVESTMENT INVESTOR CAN GIVE UP EQUITY KICKER FOR AN MS GUARANTEE TO LIQUIDATE AT MATURITY **MAKE THE CALLS**.	141
09/02/2009	ALL FC'S WHO HAVE CLIENTS INVESTED IN FIRSTLINE PRIVATE PLACEMENT...PLEASE BE ON A CONFERENCE CALL SCHEDULED FOR THURSDAY SEPT 3RD AT 10AM	250
09/25/2009	INVESTORS NEED US.......OUR CURRENT CLIENTS NEED US...........TAKING TIME FROM PROSPECTING IS NOT PRODUCTIVE.......MANAGEMENT WILL TAKE CARE OF THE ISSUES MENTIONED YOU TAKE CARE OF YOUR CLIENTS AND YOUR DEVELOPMENT OF NEW BUSINESS.....**MAKE THE CALLS**.	143
09/30/2009	CALL EVERY CLIENT OR PROSPECT WHO HAS MONEY IN MONEY MARKET.......DON'T ASSUME YOU KNOW THEY DON'T WANT TO USE THE MONEY IN AN INVESTMENT......HAVE AN IDEA (ONE OF OUR DEALS FOR THOSE WHO QUALIFY)....YOU OWE IT TO CLIENTS TO CALL THEM ABOUT MONEY MARKET FUNDS.	144
12/02/2009	ATTACHED IS THE FORTRESS LETTER THAT WENT OUT MONDAY	208

CERTIFICATE OF COMPLIANCE

I hereby certify pursuant to Rule 450(d) that the Division of Enforcement's (1) Brief in Response to Respondents' Joint Brief ("Joint Response") and (2) Response to Respondents' Individual Briefs ("Individual Response") both comply with the length limitations set forth in the Commission's July 28, 2015 Order Granting Extensions and Clarifying Prior Orders. The Division's Joint Response, exclusive of pages containing the table of contents and table of authorities is 9,808 words. The Division's Individual Response, exclusive of pages containing the table of contents, table of authorities, and two addenda, is 15,715 words.

By: [signature]
Michael D. Birnbaum

CERTIFICATE OF SERVICE

I hereby certify that on the date set forth below, I filed the foregoing pleadings with the Office of the Secretary of the Commission via facsimile at (202) 772-9324, and served copies on the following persons by UPS Next Day Air to:

Matthew G. Nielsen
Andrews Kurth LLP
1717 Main Street, Suite 3700
Dallas, Texas 75201

Roland Cavalier
Tuczinski Cavalier & Gilchrist, P.C.
54 State St. - 8th floor
Albany, NY 12207

Gilbert B. Abramson
Gilbert B. Abramson & Associates, LLC
One Presidential Blvd., Suite 315
Bala Cynwyd, PA 19004

M. William Munno
Seward & Kissell LLP
One Battery Park Plaza
New York, NY 10004

Mark J. Astarita, Esq.
Sallah Astarita & Cox, LLC
60 Pompton Ave.
Verona, NJ 07044

And by UPS Next Day Air and to alj@sec.gov upon:

Office of the Secretary (original plus three copies)
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

By: [signature]
Michael D. Birnbaum