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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING

File No. 3-15514

In the Matter of,

FRANK H. CHIAPPONE,

ANDREW G. GUZZETTI,

WILLIAM F. LEX,

THOMAS E. LIVINGSTON,

BRIAN T. MAYER, and

PHILIP S. RABINOVICH

INDIVIDUAL REPLY BRIEF ON BEHALF OF RESPONDENT FRANK CHIAPPONE, IN ACCORDANCE WITH THE COMMISSION'S ORDER

DATED: OCTOBER 27, 2015

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PRELIMINARY STATEMENT

Since the substance of Mr. Chiappone's legal arguments are contained in his original brief to the Commission and Respondents' Joint Brief, this Reply Brief will primarily address numerous inaccuracies, exaggerations and miss-characterizations found in the Division's Responding Briefs. Some recitations of the Division's statements have been abbreviated or paraphrased. The following abbreviations are used herein:

Chiappone Opening Brief to Commission: ChB-p.4
Division Brief Responding to Respondents' Joint Brief: DB-J,p.1
Division Brief Responding to Respondents' Individual Briefs: DB-I,p.1
Division Exhibit: DE-1, DE-2, etc.
Initial Decision: ID-p.9
McGinn, Smith & Company: MS&Co.
Respondents' Joint Brief to Commission: RJB-p. 5
Transcript of Hearings: TR:pp.5-8

I. RESPONSES & CORRECTIONS TO DIVISION'S ERRONEOUS AND PREJUDICIAL ALLEGATIONS

Statement#1: Investor losses would not have been possible without top-performing in-house salesmen selling the MS&Co. offerings ("DB-I-p.1").

Response#1: On this logic, every stockbroker would be liable for all investment losses, because if no sale had been made, no loss could have occurred. If mere selling caused losses, why did the Division not sue the other 40+/- brokers who also sold MS&Co. offerings? This argument ignores the proven fact that investor losses were not *caused* by defects in investment products sold, nor by brokers' misrepresentations or other illegal conduct; the primary cause was misuse of investor funds by McGinn and Smith (aided and abetted by their CFO and outside accountants) and the active concealment of that fraud over many years. Not only was Chiappone unaware of the

misuse of funds, but the SEC and NASD/FINRA (who conducted periodic investigations) and the 40+/- MS&Co. brokers *not* charged by the Division all failed to discover the fraud. Yet the Division seeks to blame the brokers, who had nowhere near the resources of the regulators.

Statement#2: Respondents [including Chiappone] are liable for "fraudulent sales of unregistered securities" and "made material misrepresentations and omissions in connection with those sales "(DB-I,p.1), and "Chiappone argues . . . that his material misrepresentations and omissions to customers should be excused for lack of scienter" (DB-I,p.10).

Response#2: Regarding lack of registration, Chiappone reasonably believed all MS&Co. offerings had complied with Reg. D, and Chiappone's customers were all sent private placement memorandums (PPMs), investor questionnaires and subscription agreements (TR:5491-5492). The PPM's clearly indicated sales were intended to qualify under Reg. D. Chiappone had no knowledge that some offerings possibly had more than the thirty-five unaccredited investors (TR:5493).

Regarding representations or omissions, Division witness Gary Ardizzone claimed that Chiappone represented that the Four Funds he purchased were similar to alarm deals he previously purchased, which had paid Ardizzone in full (ChB-pp.21-23. Chiappone testified that he did discuss the blind pool nature of the Four Funds with Ardizzone (ChB-pp.21-22), and Ardizzone recanted this assertion on cross-examination:

Q. Did Mr. Chiappone tell you that this was an alarm deal?
A. My understanding was all of these private placement things were based on the alarm business in one form or another.
Q. Well, my question to you is not what you understood. My question is, did he *tell you* that this was an alarm deal?
A. Again, my understanding from conversations with him ....
Q. Do you –
A. Whenever he had something to sell he would call and we would talk.
Q. **Do you have a specific recollection of Mr. Chiappone telling you that this was an alarm deal?**
A. **No.** [TR:2796:20 – 2797:13]

The only other Division witness called was Bruce Becker, who was very credible. Becker testified that he declined to purchase Four Funds offerings because he was uncomfortable with the blind pool structure of the investment, *which was explained to him by Chiappone.*[1] This casts considerable doubt on Ardizzone's claim that he thought the Four Funds were alarm-based investments. Mr. Becker further testified that he considered Chiappone an honest broker and stated that he *continued to conduct business with Chiappone after the Division commenced this proceeding*! (TR:2946; ChB- p.23).

Further doubt was cast upon Ardizzone's testimony by two Chiappone witnesses, both of whom lost money on MS&Co. offerings. Both testified they considered Chiappone to be an honest broker.[2] Leanne Sweet also specifically testified Chiappone did explain the Four Funds were different from the alarm trusts:

Q. Did Mr. Chiappone ever say, in words or substance, "These are different from the burglar bonds that you have been buying"?

A. Oh, yes. I remember the burglar bond comment. Yes. These are different from the burglar bonds. That I do remember.[3]

No other investor accused Chiappone of misrepresentations or other wrongful conduct. No documentary evidence was introduced establishing that Chiappone was guilty of any misrepresentation, failure to disclose known facts, or other misconduct in the sales process. The Division cites no proof that any PPM sent to Chiappone's customers contained any material misrepresentations or omissions. In sum, no proof supports the Division's claims of fraud in selling securities.

Statement#3: Respondents [Chiappone] committed "egregious violations of the securities laws" (DB-I,p.1).

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[1] Becker testimony, Tr. 2936:22 – 2937:21; Chiappone testimony, Tr. p. 5486.
[2] See testimony of Leanne Sweet, TR:5361-5386; Jerry Mirochnik, TR:3112-3132.
[3] TR:p.5390.

Response#3: Chiappone did nothing remotely close to "egregious," and no testimony or other proof substantiates the Division's "egregious conduct" assertion. Further, the ALJ found that Chiappone's violations of Securities Act, §§17(a)(2)&(3) were effected by "acting at least negligently ...." (ID-p.100). While denying that Chiappone was even negligent, it is clear that simple negligence does not amount to "egregious conduct." Nor does his inability to detect hidden fraud committed by McGinn and Smith constitute egregious conduct.

Statement#4: Pre-2003 trusts not rolled into IASG's IPO were redeemed using Four Funds investors' money and Selling Respondents knew this (DB-I,p.3), and "Respondents were the keystone of a scheme to defraud investors" (DB-J,p.25).

Response#4: While DE-2 (¶¶ 25-50) establishes that Four Funds money was used to rescue some failing pre-2003 trusts, no evidence was introduced that Chiappone knew of this misuse of funds. The IASG IPO was underwritten by Friedman, Billings & Ramsey, Stifel Nicolaus and Wells Fargo, and reviewed by PriceWaterhouseCoopers, so Chiappone every reason to believe this was a legitimate offering. Moreover, the Division's summary witness, Karri Palen, specifically testified that she found no indication that *any of the brokers* were aware of this diversion of funds (Palen testimony, TR:393-397), or any other fraudulent activity by McGinn and Smith. Ms. Palen, a certified fraud examiner, spent over three years (devoting half her time on the MS&Co. investigation) to fully discover and document the extent of the fraud. Her lengthy and thorough investigation disclosed nothing suggesting that Chiappone ever knew of the fraud, completely belying the Division's allegation that Respondents should have recognized this "red flag," and were "keystone" participants in the fraud. Ms. Palen testified:

Q. ...[B]asically what you are saying is that the Four Funds took money from investors and then used that money to redeem or pay off notes issued earlier in the so-called alarm deals. Correct?
A. Correct

Q. Did you see, in the course of your investigation, any document that indicated to you that Mr. Chiappone *participated* in any of the transactions described in that section of the declaration?

A. ... I don't see any.

....

Q. In the course of your examination, did you see any document that indicated that Mr. Chiappone *even knew about* any of the transactions set forth in that section of your declaration.

A. That wasn't part of what I was asked to look at.

Q. **But the question is, did you see a document that indicated Mr. Chiappone *even knew about* those transactions –**

A. Knew about the transactions? No.

Q. -- that are set forth in that section of the declaration, the use of the Four Funds money for the pre-alarm trusts?

A. No. (TR:392-396)

....

Q. There is nothing in your declaration, is there, that Frank Chiappone had any connection to any of the transactions that you have identified in your declaration as fraudulent transactions. Correct?

A. Correct. (TR:397].

Smith's handwritten letter (Livingston Ex. 30), made it clear that he and McGinn went to great lengths, over more than 20 years, to conceal their gross misuse of investor funds (TR:5614-5618. One passage vividly confirms that they concealed their actions from their own employees:

> "Certainly by not disclosing in the prospectus our poor history of collections, we are not providing the prospective investor an accurate picture of his risk. We both know why we don't make that disclosure, because such disclosure *would cause our salesmen to cease selling and investors to cease buying, thus we are misleading both our own employees and customers.*" TR:5618 (emphasis supplied).

The Division's allegation that Chiappone knew or should have discovered the misuse of investor funds remains unproven and contradicts its own fraud expert's (Palen's) testimony.

Statement#5: Money from the 2006–2009 Trust Offerings was used to enrich McGinn, Smith, MS&Co. and affiliates, and total funds invested was less than specified in the PPM's (DB-I,p.4).

Response#5: No evidence was introduced establishing that Chiappone ever knew of any diversion of funds to enrich McGinn and/or Smith, or that McGinn failed to invest amounts specified in the PPM's. He had no access to MS&Co. internal accounting records. The Division cites no exhibits or testimony supporting this undocumented allegation.

Statement#6: The Pre-2003 Trusts failed and Respondents knew or should have known of this (DB-I,p.5).

Response#6: The Division points to no exhibits and no testimony establishing Chiappone's alleged knowledge of Pre-2003 Trust failures; they simply make unfounded allegations. He testified that almost all of his customers purchasing Pre-2003 Trusts were paid in full, so he had no reason to even *suspect* those investments were troubled (TR:5466-5468). Again, Ms. Palen testified that her investigation yielded no evidence that Chiappone or other brokers were aware that some pre-2003 offerings had financial issues. His lack of actual knowledge of any problems with those trusts is further evidenced by his subsequently investing his own money and that of family members in later offerings. (See, DE-2[Sched. 4c, pp.58,61,62,66; TR:2638 lines 10-13; TR:2641 lines 17-21).

Statement#7: There were obvious conflicts of interest relating to the Four Funds offerings and the Four Funds entered into transactions with affiliates (DB-I,pp.5&6).

Response#7: Potential conflicts were obvious – **obvious to all,** as they were disclosed in the PPM's. Upending the concept that *failure to disclose conflicts* violates securities laws, the Division claims that publishing PPM's which fully disclose conflicts constitutes a badge of fraud. Two experts, both seasoned security industry veterans, explained that conflicts disclosed in a PPM do not heighten registered representatives' obligations. A "conflict of interest relative to issuers being affiliated with broker-dealers is almost a daily event." (Tilkin, TR:3941:2-13); and affiliations

between issuer and underwriter in the offer of proprietary products "happens all the time" (Bennett,TR:4039:21-4040:8). It was not the interrelationships between various MS&Co. entities that *caused* the losses; it was the subsequent diversion of funds engineered by convicted felons.

Statement#8: Smith's requiring brokers to find buyers before redeeming maturing notes was a departure from the PPM's (DB-I,p.7), and "Chiappone also understood that he needed to have 'replacement tickets' whenever a client wanted to redeem Four Funds investments" (DB-I,p.13,fn6).

Response#8: The ALJ ruled the so-called "redemption policy" was not a red flag (ID-p. 93). Moreover, stating this was a departure from the PPM's is categorically untrue. Each PPM contained, at the top of the first page, language specifically disclosing MS&Co.'s ability to re-sell maturing notes.[4] Further, Chiappone explained how, with 25% of notes having a 1-year maturity, it was a virtual certainty that notes would be either rolled over or re-sold (TR:5591–5594; Chiappone Brief to ALJ, pp. 60-61). Rollovers and resales did not depart from the PPM's; they were made *as authorized* by the PPM's.

Statement#9: The January 2008 meeting and Four Funds "default" put Respondents on notice of fraud at MS&Co (DB-I,pp.8-9).

Response#9: That meeting – for the first time – disclosed problems with some Four Funds notes (others continued to pay interest in full). However, stockbrokers were not told of misuse of funds, investments in affiliated companies, lack of diversification in investments, or other information that might raise suspicions of wrongdoing. Instead, Smith blamed the restructuring of some notes on the well-publicized meltdown in global public markets. That explanation seemed reasonable in the context of what was happening to investors world-wide, and Chiappone initially

[4] See PPM's for FIIN, FEIN, TAIN & FAIN, exhibits Div-5, Div-6, Div-9 & Div-12.

believed it. While not then suspecting fraudulent conduct, he nevertheless immediately stopped selling Four Funds, never again selling a Four Funds note.[5] By August 2008 Chiappone came to suspect that Smith's "market meltdown" explanation was not the only problem (DE-231). That suspicion was confirmed December 30, 2008 when Smith refused Chiappone's request to disclose the Four Funds investments (DE-425; TR:2691-2692;2722-2723).

Statement#10: After the January 2008 meeting, "Respondents nevertheless continued to sell MS&Co. products" (DB-p.9).

Response#10: By using the word "products," the Division disingenuously argues that the Four Funds problems constituted a "red flag" as to subsequent MS&Co. Trust Offerings. After the January 2008 meeting Chiappone sold *only* Trust Offerings; he sold no more Four Funds. The Division has admitted in writing on three occasions that the Trust Offerings were entirely different securities from the Four Funds:

(1) DE-1 (Division's Expert Witness Report) in which Lowry states "These offerings *were not at all similar* to the income notes [Four Funds] ...."[6]

(2) Division's proposed Findings of Fact stated "The Four Funds Had a Totally Different Mandate than the Pre-2003 Trust Offerings"[7]; and

(3) DB-I, p.5 states "The Four Funds investment mandate differed entirely from the Pre-2003 Trusts, and at p. 11, states: "Chiappone knew that the Four Funds . . . had a much different investment mandate compared to the Pre-2003 Trusts."

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[5] Chiappone's Four Funds transactions listed on DE 2 (schedule 4c) after January 8, 2008 were not new sales. The 3/17/08 transaction was a re-registration of a Chiappone holding from his personal account to his TOD account. The 7/7/08 transaction was re-registering a FEIN Note bought by Werner Paul on 5/10/2004 into his IRA account (Chiappone testimony, TR:1083).

[6] Lowry Report, (DE-1),p.25.

[7] Division Proposed Findings of Fact, at p.32 (paragraph heading "A" to Point VIII.

Structural differences between the Four Funds and the Trusts are detailed in Chiappone's initial brief (ChB-p.18). The Post-2006 Trusts were identical in structure to the Pre-2003 Trusts, involving identified investments and recurring monthly revenues ("RMR"). Chiappone viewed the return to RMR-based investments as getting back into a business that MS&Co. had (to his knowledge) conducted successfully and in which they were steeped in experience.[8] Four Funds failures in no way was a red flag as to the subsequent Trust Offerings.

Statement#11: Chiappone . . . continued to sell Firstline after Firstline's public bankruptcy filing (DB-I,p.9).

Response#11: This statement is likewise misleading. While Chiappone sold Firstline after the bankruptcy filing (January, 2008), he was not aware of the bankruptcy filing until September 3, 2009, *twenty months later*. After the September, 2009 disclosure Chiappone never sold another Firstline investment, and sold only one other MS&Co. offering.[9] A complete recitation of the facts regarding Firstline, including MS&Co.'s actively misleading the brokers is at ChB-pp.18-19.

Statement#12: Chiappone argues ... that he was not required to conduct any investigation into the securities he sold as a matter of law (DB-I,p.10).

Response#12: Chiappone's arguments on the "duty to investigate" are detailed in his original brief (ChB-pp.13-17) and Respondents' Joint Brief (RJB-pp.5-9). Chiappone does not contend that an individual stockbroker is *never* under a duty to investigate; only that a stockbroker is not *always* obligated to duplicate a satisfactory investigation conducted by his firm's due diligence team. He does not argue *Hanly*[10] was wrongly decided – rather that *Hanly* is being misapplied in this case. Specifically, the same due diligence team that vetted the Pre-2003

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[8] Chiappone testimony, Tr. pp. 5448 – 5450.
[9] Chiappone Testimony, Tr. 5588 – 5589, ID-p.15 & fn. 25, Palen Ex. 4c to Div. Ex 2.
[10] *Hanly v. SEC*, 415 F2d 589 (2d Cir. 1969).

offerings also performed extensive due diligence on the post-2006 Trust Offerings.[11] That team possessed the education, training and experience necessary to evaluate the collateral supporting the Trust Offerings, performed extensive due diligence on those offerings, and conveyed their findings to the stockbrokers. To suggest that stockbrokers cannot rely on co-workers whose primary job was to conduct due diligence, but must duplicate their efforts, defies logic and is not supported by any precedent. Moreover, complete chaos would occur if all 50+/- MS&Co. brokers conducted their own investigations of every aspect of each offering.

The ALJ ignored testimony that Chiappone attended meetings at which each offering was explained, asked questions, received answers, read key portions of the PPM's, and performed interest coverage calculations, thereby satisfying his duty to understand products he sold.[12] Even the Division admits this in its brief: "A broker must discharge his own obligations to *understand* the products he recommends" (emphasis supplied)(DB-I,p.11). If *Hanly,* as applied by the ALJ, is law, then every stockbroker must also become a securities analyst. Extensive discussion of the misapplication of *Hanly* is found at ChB-pp.13-17; RJB-pp.5-9.

Statement#13: Chiappone knowingly or recklessly recommended Four Funds and Trusts, and admits he never conducted any meaningful investigation into the Four Funds (DB-I,pp.10,13).

Response#13: ALJ Murray never made a factual finding that Chiappone acted knowingly (i.e., intentionally) or recklessly. She only found he acted "at least negligently" (ID-p.100), citing *Dain Rauscher,*[13] which holds negligence suffices for violations of Securities Act §§ 17(a)(2)&(3). But, those sections also require that Chiappone must have either (i) obtained money or property by means of any untrue statement of a material fact or any omission to state a material fact ...., or (ii)

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[11] Testimony of Mary Ann Cody, TR:4547-4548; Chiappone at TR:5430-5431 (return of diligence team to MS&Co. in 2006).

[12] Chiappone testimony, TR:5450, line23, 5451-5452.

[13] 254F3d at 856.

engage[d] in any transaction, practice or course of business which operates ... as a fraud or deceit upon the purchaser." As previously noted, absolutely no documentary or testamentary evidence established that Chiappone ever made a misleading statement, or omitted to disclose any fact (all such disclosures were in the PPM's). She did not find Chiappone guilty of fraud.

The ALJ noted that *scienter* is required for violations of Securities Act §17(a)(1), Exchange Act 10(b) and Rule 10b-5.[14] Recklessness requires "a state of mind *approximating actual intent, and not merely a heightened form of negligence."*[15] Because Chiappone had no motive to defraud his clients, circumstantial evidence of recklessness must "be correspondingly greater."[16] Absolutely no proof was adduced establishing intentional or reckless conduct by Chiappone. Hence, the Initial Decision as to Chiappone must be overturned.

Regarding allegations that Chiappone did not conduct a meaningful investigation into the Four Funds, there was nothing to investigate. When Four Funds offerings commenced, Smith had not chosen what investments he would make. The blind pool structure was fully disclosed in the PPM's. Chiappone justifiably relied on Smith's substantial experience in capital market transactions (Tilken testimony on Smith's experience, acumen and background, TR:3921).

FINRA Regulatory Notice 10-22 (April 2010) sets forth extensive criteria for a broker-dealer's investigation in Reg. D blind pool offerings. Footnote 1 notes the guidance is also applicable to a registered representative's *concomitant responsibilities* to his customer. The term "concomitant" does not mean "identical to" or "same as." Rather, it refers to "existing or occurring with something else, often in a lesser way; accompanying; concurrent (Dictionary.com), or "happening at the same time as something else" and "accompanying *especially in a subordinate or incidental way*" (Meriam-Webster.com; emphasis supplied). Thus, Notice 10-22 and fn. 1, read

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[14] ID-p.98, citing *Aaron v. SEC,* 446 US 680, 695-97.
[15] *South Cherry St., LLC v. Hennessee Group LLC,* 573 F3d 98,109 (2d Cir 2009).
[16] *Kalnit v. Eichler,* 264 F3d 131, 138-39 (2d Cir. 2001).

properly, do not impose on a stockbroker the identical duties imposed on a broker-dealer. It imposes related, but not overlapping duties. Specifically, absent special circumstances, broker-dealers must perform due diligence on the product sold (reasonable basis suitability) and registered representatives must perform customer specific suitability (know your customer). Chiapone submits this is nothing new – the concomitant obligations of the firm and its brokers have always been thus. Therefore, the ALJ's determination that individual stockbrokers must conduct or even duplicate all components of due diligence on a product not only defies logic, but long-standing industry practices. Only under special circumstances does *Hanly* come into play, raising the standards for individual brokers. Such is not the case here.

Statement#14. (1) Chiappone claims his lack of diligence was motivated in part by his belief that prior MS&Co. deals had been successful ....

(2) Chiappone was faced with red flags ... [including] issuers were newly created entities with no operating history .... (DB-p.11).

Response#14: (1) This allegation parrots ALJ's finding that Chiappone had no reasonable basis for recommending the Post-2006 Trusts (ID-p.100). But Chiappone did have a reasonable basis, including nearly all of his clients buying Pre-2003 alarm trusts having been paid in full. While Chiappone knew the IASG IPO involved consolidating most Pre-2003 offerings into a single entity, he did not know (and the Division's Ms. Palen testified she found no evidence that Chiappone knew) of IPO funds being used to payoff troubled trusts. Believing MS&Co. was returning to a business that had been successful in the past, Chiappone had a reasonable basis for recommending the similar (and more secure) offerings.[17] Even the ALJ acknowledged that MS&Co. "had a national reputation in alarm financing" (ID-p.3), which supports Chiappone having had a reasonable basis for recommending the 2006 Trust Offerings.

[17] Chiappone, testimony, TR:pp5450, line20.

(2) While a new entity was formed for each offering, the same management team was in place for all Trust Offerings. Expert testimony establishes that many brokerage firms use new entities in private placements, and the expert did not consider the MS&Co. offerings to be "smaller companies of recent origin" (TR:3925-3927). Mr. McGinn located the assets to be purchased, negotiated terms, structured the deals, and managed the assets purchased. MS&Co.'s due diligence team (substantially identical to the team that vetted the Pre-2003 alarm deals)[18] performed the same investigations for the Post-2006 alarm and triple play offerings as they did for Pre-2003 alarm deals. Chiappone testified that he knew that MS&Co. management was running all offerings, and did not consider the issuers to be "unseasoned."[19] Regarding the Four Funds, Chiappone knew Smith had a background in capital market investments, having funded various local businesses and significant projects.[20] Chiappone believed that Smith's many years managing his own customers' brokerage accounts was essentially no different than selecting investments for the Four Funds.[21]

Statement#15: When Smith refused Chiappone's request for a list of investments in TAIN in December 2008, "Chiappone just left it at that rather than ask further questions" (DB,p.12), and Chiappone "should have been particularly suspicious when Smith refused to share with them details about Four Funds investments (DB-J,p.21).

Response#15: This accusation (relating to events occurring in December, 2008) is irrelevant because Chiappone sold no Four Funds investments after January 8, 2008 (DE-2,Schedule 4c), so asking further questions would have been superfluous. Likewise, suspicions as to Smith's abilities were irrelevant, as Chiappone never sold another investment run by Smith (McGinn ran the Trusts).

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[18] Chiappone testimony, TR: p. 5430.
[19] Chiappone testimony, TR: pp. 5439 – 5441.
[20] Chiappone testimony, TR: pp. 5462 – 5466.
[21] Chiappone testimony, TR:. pp. 5465.

Statement#16:

(1) After Chiappone's email accusing Smith of using the market meltdown as a screen for mismanagement of Four Funds investments (DE-231), he "continued to sell McGinn Smith products after he came to distrust Smith." (DB-I,p.12);

(2) Chiappone sold later [Trust Offerings] "after arriving at the conclusion that he could not trust the man behind those deals." (DB-I,p.12); and

(3) Chiappone sold MS&Co. products after he discovered that the Four Funds held the same investments (DB-I,p.13).

Response#16: (1) Chiappone's email to Smith dated 8/28/08 was never sent. Moreover, Chiappone stopped selling Four Funds before he wrote that email. After January 8, 2008, he only sold Trust Offerings (run by McGinn); not the entirely different Four Funds (run by Smith). Chiappone believed the return to RMR-based products was getting back to a business that MS&Co. new well and had returned almost all of his customers their invested funds and interest.[22]

(2) The Divisions suggestion Smith was "the man behind those deals" [Trust Offerings] is dead wrong. McGinn ran the Post-2006 Trust Offerings, and Chiappone had no reason to doubt McGinn's ability or integrity *at that time*. Only when the Firstline bankruptcy was disclosed in September 2009, did Chiappone have reason to distrust McGinn. When that happened, he immediately began to seek other employment, and left MS&Co. approximately three months later.[23]

(3) Several months before Chiappone realized (in December 2008) that the Four Funds were not separately diversified, he had already ceased selling the Four Funds.

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[22] Chiappone testimony, TR:2644-2646 (only one Pre-2003 alarm offering (SAI) did not pay in full).
[23] Dates taken from FINRA's Broker Check on Chiappone (DE-479).

Statement #17: "Chiappone knew that more than one-third of proceeds raised from the Benchmark offering would be reserved for fees and expenses ... and the Benchmark PPM described conflicts of interest relating to MS&Co. [dual roles]." (DB-p.13).

Response#17: Once again, the Division inverts reality by complaining about *disclosed* fees and *disclosed* conflicts of interest. Also, the Division overstates the percentage of funds used for fees. Fees and expenses amounted to 25.2% if the minimum funds were raised.[24]

Statement#18: The brokers, including Chiappone, "sold fraudulent securities" (DB-p.1; DB-J,pp.1,22).

Response#18: The securities themselves were not bogus or fraudulent. The Pre-2003 and Post-2006 Trusts were legitimate debt securities, secured by RMR and receivables on alarm (and triple play) contracts, purchased from legitimate businesses not affiliated with MS&Co. While the Four Funds bore a higher level of risk, the fact that investments would not be selected until after funds were raised, and the broad range of potential investments, was fully disclosed in the PPM's. The fraud engineered by McGinn and Smith took place after the selling process and was the true cause of losses.

II. OTHER ARGUMENTS

1. Division Cannot Seek Review of Initial Decision. The Division requests the Commission to over-rule the ALJ on the length of the suspensions for Respondents, including Chiappone. However, SEC Rules of Practice bar the Division from now seeking any affirmative relief. Rule 410(a) provides: "In any proceeding in which an initial decision is made by a hearing officer, any party ... may file a petition for review with the commission." Rule 410(b) provides: "In the event a petition for review is filed, any other party to the proceeding may file a cross-

[24] Calculations can be made based on the table of Sources & Uses found at DE-63,p.8. For example: $$75,000+$20,000$150,000+$400,000+$5,000+$50,000=$700.000. $700,000 / $2,780,000 = 25.2%.

petition for review within the original time allowed for seeking review or within ten days from the date that the petition for review was filed ...." Having failed to file (and serve Respondents) with a Petition or Cross-Petition For Review, the Division cannot now seek to alter the ID. Rule 410(c) limits the Commission's ability to review the ID on its own initiative to 21 days after the end of the period for filing a petition for review under 410(b), which time limit has already expired.

2. The Division Misconstrues Platinum Investments. The Division argues that *SEC v Platinum Investment Corp* requires that (1) the investigation be performed by the selling broker; (2) the broker is not entitled to rely on information given to him by the brokerage firm superiors; (3) a broker cannot rely solely on information given to him by his employer or the issuer (DB-J,p.17). The facts in our matter are dramatically different from those in *Platinum. Platinum* involved sale of unregistered securities with no attempt to qualify for Reg. D or any other transaction exemption. The broker told investors the issuer was about to float an IPO with an opening price of $3.30, moving to $8 or $9, and the issuer had virtually no assets and no history of operating revenue. It had no due diligence team such as existed at MS&Co. Under *Platinum's* facts, imposing a duty to investigate upon a broker makes sense.

The situation with the 2006 Trust Offerings is diametrically opposed. The MS&Co due diligence team did investigate the assets. MS&Co. had in-house counsel and accountants, and seasoned investment bankers (McGinn as to the Trust Offerings). The PPM's were prepared by MS&Co. in-house counsel (sometimes with outside counsel). Under these circumstances, brokers were entitled to rely on the performance of the due diligence investigation without having to duplicate it. Under these facts, the duty of the broker is to **understand the securities he is offering; not to perform every step of the due diligence on his own.**

3. Chiappone was Prejudiced by Any Evidence Regarding the Four Funds. Chiappone never sold a Four Funds investment within the five year period of limitations. Hence, all evidence admitted by the ALJ as to Four Funds unduly prejudiced Chiappone, who sold only Trust Offerings, backed by contract receivables, within five years prior to the filing of the OIP.

4. Chiappone Should Not Be Suspended. Chiappone was suspended for 12 months on the ALJ's finding that "Respondents currently work in the securities industry, so there appears to be a strong likelihood of recurrence" (ID-p.113). As detailed in Chiappone's Individual Brief, this totally ignores the fact that, at time of trial, Chiappone had not sold a single private placement since leaving MS&Co. in December 2009, a period of over four years. At present, he still has not sold a private placement, and it has been almost six years since his last sale. It is submitted that this conclusively proves that the likelihood of Chiappone becoming involved in selling a proprietary private placement is nil; therefore no suspension is required to protect future investors.

CONCLUSION

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

Dated: October 27, 2015

Respectfully Submitted,

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING

File No. 3-15514

In the Matter of,

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

ATTORNEY'S CERTIFICATION REGARDING PAGE REQUIREMENTS

ROLAND M. CAVALIER, states under oath that he is the attorney for Respondent Frank Chiappone in this matter and that he was the person primarily responsible for the Individual Reply Brief being submitted on behalf of Mr. Chiappone. According to the electronic word count obtained from the Microsoft word program upon which the Brief was prepared, the Brief does not contain more than 5,000 words (specifically, 4,988 words), excluding cover page, table of contents and table of authorities.

Dated: October 27, 2015

TUCZINSKI, CAVALIER & GILCHRIST, P.C.

By: _____
ROLAND M. CAVALIER

ORIGINAL

CERTIFICATE OF SERVICE

I, Roland M. Cavalier, hereby certify that on this 27th day of October, 2015, I [illegible] complete copy of Respondent Frank A. Chiappone's Individual Reply Brief, u[illegible] parties in this action as follows:

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Sworn to before me this
27th day of October, 2015.

Notary Public – State of New York

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Qualified in Saratoga County
Reg. No. 02VA4739628
Commission Expires May 31, 2019