UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

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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

JOINT REPLY BRIEF ADDRESSING CERTAIN LEGAL ISSUES IN ACCORDANCE WITH THE COMMISSION'S ORDER

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PRELIMINARY STATEMENT[1]

The Division contends that McGinn and Smith's secret fraud "would not have been possible without" Respondents' sale of McGinn Smith Securities. (DIB at 1).[2] The Division's over-reaching argument ignores undisputed facts, including:

- Some 40 other registered representatives sold $69 million of McGinn Smith Securities, more than half the amount sold to investors, and none of them saw any "red flags." *See* Div. Ex. 591; Tr. 5076:10-15, Tr. 5790:7-21;

- Respondents did not know of McGinn and Smith's fraud and the ALJ made no finding that they did. *See* Decision at 4;

- The SEC, the NASD and an outside consultant who reviewed MS&Co. did not see any red flags or fraud. *See* Livingston Ex. 103, RMR Exs. 40, 120, 135, 161, 184;

- National Financial Services (NFS), a Fidelity entity that custodied the McGinn Smith Securities, valued them at par (or par less amortization), and customers received interest payments until the Receiver was appointed in April 2010;[3]

- McGinn Smith Securities were not themselves fraudulent, and McGinn and Smith's secret theft and diversion of a portion of investors funds occurred *after* customers invested and unbeknownst to Respondents.

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1 The Commission's *sua sponte* limitation of the word count, to which Respondents object, did not allow for amplification of the points presented in this Reply.

2 Capitalized terms have the meaning given to them in Respondents' Joint Brief dated July 17, 2015 ("JB"). "DIB" refers to the Division's Response To Respondents' Individual Briefs, dated September 30, 2015. "DB" refers to the Division's Response To Respondents' Joint Brief, dated September 30, 2015.

3 The junior notes of the Four Funds paid interest until January 2008 and one of the Firstline certificates paid interest until September 2009.

Ignoring this undisputed evidence, the Division accuses Respondents of being "the keystone of a scheme to defraud investors." DB at 25. The evidence does not support the Division's unfair "blame game." The Division's premise – that these Respondents alone should have discovered McGinn and Smith's secret fraud when no one else did, and that they should be punished because they and their customers purchased more McGinn Smith Securities than other brokers who sold them – is false. Eighteen days of testimony and more than 700 exhibits did not support the Division's assertion that *these* Respondents should have "figured it out."

While the Division trumpets "red flags," most were rejected by the ALJ, and those that remained, were not red flags at all. The PPMs contained standard disclosures, and the January 2008 reduction in interest on a single class of Four Fund notes was unsurprising given the Great Recession. The evidence did not support a finding of any red flags that altered Respondents' obligations to understand the product and to conduct a customer-specific suitability analysis. *See* JB at 12-13.

What is more, the alleged red flags related to the Four Funds[4] – not the Trusts, which the Division admits were entirely different products. Respondents did not sell the Four Funds after September 23, 2008, and thus, any claim relating to them is time barred under Section 2462. Like everyone else, Respondents were unaware of McGinn and Smith's secret fraud, which did not wave "red flags."

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4 One alleged red flag – McGinn and Smith's disclosure of the Firstline bankruptcy in September 2009 – did relate to a Trust Offering. But Respondents did not sell McGinn Smith Securities (with a few exceptions) after that disclosure.

Because the overwhelming evidence demonstrated that each Respondent did not violate any securities laws and fulfilled his duties as a registered representative (or manager),[5] all charges against them should be dismissed.

ARGUMENT

I.

RESPONDENTS DID NOT ACT INTENTIONALLY, RECKLESSLY OR NEGLIGENTLY

The Division failed to show that Respondents engaged in intentional or reckless conduct as required by law. *See* JB at 10-13 (citing, among others, *Aaron v. SEC*, 446 U.S. 680, 690, 695 (1980)). The Division ignores that the circumstances here are dramatically unlike those in *Hanly* and its progeny. Nor did Respondents act negligently.

A. Hanly And Its Progeny Are Not Applicable

The Division's repeated recitation of snippets of *Hanly* and its progeny does not change the fact that none of those cases is remotely similar to the facts here. Those cases merely hold that a broker may not blindly pass along factual representations that are obviously false, outlandish or of doubtful veracity, without some reasonable basis supporting the facts represented. Respondents had a reasonable basis and fulfilled their suitability obligations. *Hanly* does not apply.

In *Hanly*, the brokers falsely claimed to have purchased stock they were recommending for their own accounts and that the stock would "go from 6 to 12 in two weeks," or "double after three or four weeks," despite knowing the company had no working capital and was operating at a loss, and without disclosing this information to their customers. *Hanly v. SEC*, 415 F.2d 589, 593-95 (2d Cir. 1969). No such facts were presented here.

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5 *See* each Respondent's Individual and Reply Briefs.

In *SEC v. Platinum*, the Court concluded that defendant was "undoubtedly reckless" because he "failed to take even the most rudimentary steps to make sure his recommendations to his clients were responsible and reasoned," "did nothing to confirm his price or performance predictions," "did nothing to familiarize himself with private placements," and failed even to read the materials going to his customers. *SEC v. Platinum Inv.*, 2006 U.S. Dist. LEXIS 67460, at *8, *12, *16 (S.D.N.Y. Sept. 20, 2006). Platinum's fly-by-night brokerage operation was nothing like MS&Co.'s established investment banking business. *See*, *e.g.*, RMR Exs. 292, 293, 226.

In *SEC v. Milan Capital Group*, the broker enabled the sale of phony IPO securities and played a material and knowing role in the fraud, providing false sales confirmations for IPO shares when, in fact, there was no access to such shares. 2000 U.S. Dist. LEXIS 16204, at *5-6, *13-21 (S.D.N.Y. Nov. 9, 2000). By contrast, investors in McGinn Smith Securities invested in legitimate private placements and, with a few exceptions, received regular interest payments until the Receiver was appointed in 2010.

The remaining cases cited by the Division are similarly distinguishable. In each of these cases, the brokers knew of and participated in the fraud and their conduct caused the loss. In contrast, McGinn and Smith's secret fraud, coupled with the liquidity crisis and global recession, caused investor losses – not Respondents' conduct.

Further, the egregious facts in these cases confirm that only knowing or recklessly deceptive misrepresentations or omissions are actionable under Section 10(b), Rule 10b-5, and Section 17(a)(1) – conduct that was *not* present here. JB at 10-12. Nor was any evidence presented that Respondents evinced an actual intent to defraud or engaged in conduct so unreasonable that it "represent[ed] an extreme departure from the standards of ordinary care."

Rolf v. Blyth, Eastman Dillon & Co. Inc., 570 F.2d 38, 47 (2d Cir. 1978). Indeed, Respondents and their family members purchased McGinn Smith Securities, a point the Division has ignored.

B. The Alleged Red Flags Did Not Alter Respondents' Duties As Registered Representatives

The Division argues that "Respondents undertook a course of deceptive conduct" because they offered McGinn Smith Securities supposedly "after numerous red flags made it clear that something was amiss at the broker-dealer." DB at 26. The evidence, expert testimony, and case authority demonstrate that there were no flags that altered Respondents' duties as registered representatives. *See infra.*

The Division expressly acknowledged it is limited to the red flags alleged in the OIP. *See* Division's Opp. to Motions for More Definite Statement dated Nov. 25, 2013, at 7 ("The red flags discussed in the OIP are the red flags that will be presented at trial."); Tr. 272:11-13 ("red flags listed in the OIP....are the red flags we are presenting"). Yet, the Division ultimately argued that there were 10 red flags (*see* Decision at 84), far more than alleged in the OIP.[6] The ALJ rejected most of them. *See* Decision at 91 ("declin[ing] to discuss several of the purported red flags that I have determined to not constitute a red flag"). The alleged red flags addressed by the ALJ are discussed below.

1. The PPMs Contained Standard Disclosures

The record established that the PPMs contained standard disclosures. *See, e.g.*, RMR Ex. 861; Tr. 3941:2-13; Tr. 4039:21–4040:8; Tr. 3921:4-17, 3927:17-25; 3925:6-15;

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6 The Division now contends, for the first time, that ancient events from 1990 to 2003, referenced in only two footnotes in the OIP (OIP nn. 3-4) – the Pre-2003 Trusts and the July 2003 IASG IPO – were the initial red flag. *See* Div. Br. at 17 and Div. Ind. Br. at 2-3. The IPO was underwritten by Wall Street firms, reviewed by PWC, received positive financial press, and resulted in the payment of all principal and interest to investors. *See, e.g.*, Tr. 4565:2-8 (Cody); Div. Ex. 373 at 73, 75; RMR Exs. 7, 8, 9, 35, 37. It was not a red flag.

3926:24–3927:9. There is no basis to conclude that these standard disclosures were "so obvious[ly]" indicative of fraud "that the defendant must have been aware of [the fraud]." *See South Cherry St., LLC v. Hennessee Group LLC*, 573 F.3d 98, 109 (2d Cir. 2009) (defining red flag); JB at 18-20.

Moreover, it is undisputed that customers received PPMs and signed subscriptions documents that clearly disclosed the risks of each McGinn Smith Security and made an informed decision to invest. JB at 18-21. Respondents are not "blam[ing] their customers," as the Division claims, DB at 23, but rather setting forth evidence that (1) oral testimony of a few investors years later is questionable when it contradicts their contemporaneous written representations, (2) under the objective test for materiality, a reasonable investor would *not* have believed his investment to be safe where, as here, there are clear, written disclosures to the contrary, and (3) as a matter of law, the Commission should find that these statements are not actionable, consistent with governing federal law. *See* JB at 21-22.

2. *The (Non-Existent) Redemption Policy*

The ALJ concluded that the "redemption policy"[7] did not exist. Decision at 93. The evidence showed that customer redemptions were honored whether the Respondent had a new customer or not. *See, e.g.*, Tr. 2175:10-13.

3. *The January 2008 Meeting Was Unremarkable Given the Liquidity Crisis and Global Recession*

Far from "blindly accepting" Smith's explanation that the faltering economy was to blame for the reduction of interest on just the *junior* notes announced in January 2008, DB at

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[7] According to the OIP, the redemption policy "required [Respondents] to 'replace' customers seeking to redeem notes with new customers before the redemption would be honored." OIP ¶20. It is undisputed that the PPMs clearly disclosed that the notes were illiquid and that there was no market for them. *See* JB at 18-19; *see, e.g.*, Div. Ex. 5 at 11; Div. Ex. 264 at 3.

22, Respondents knew that investments made by the Four Funds were battered by the global economic crisis or depended on debt refinancing that was unavailable because of the liquidity crisis.[8] Nor was Smith's explanation inconsistent with an email from Respondent Guzzetti that the Four Funds had "no correlation" to the *equity market*. *See* Div. Ex. 111. The Great Recession of 2008 affected far more than the "equity market" – it "wreaked havoc...across the country...[and] businesses large and small...felt the sting of a deep recession." Tr. 5751:19–5752:8 (quoting *Select SEC Market Data*).

There was nothing "amiss" at the January 2008 meeting that Respondents knew about. Nor does the Division explain how Respondents could have uncovered McGinn and Smith's secret fraud had they only "investigate[d] the reasons for the Four Funds collapse." DB at 21-22. In any event, the reduction of interest on the junior notes had nothing to do with the Trust Offerings, which the Division's expert admitted "were not at all similar" to the Four Funds.[9]

4. *Respondents Were Unaware of the Firstline Bankruptcy*

The final alleged red flag was McGinn and Smith's failure to disclose the Firstline bankruptcy to Respondents until September 2009. *See* Decision at 93. The Division admitted that Respondents were unaware of the Firstline bankruptcy before September 2009. *See* Div. FoF ¶178. Respondents did not present any McGinn Smith Securities (with a few exceptions) after the disclosure, and several left MS&Co. shortly thereafter.

C. *Respondents Had A Reasonable Basis For Offering McGinn Smith Securities*

The Division's assertion that Respondents had no reasonable basis for offering McGinn Smith Securities ignores the record. *See* DB at 15-19. First, Smith was more than

8 RMR Ex. 305 (showing market collapse of 2008).

9 Div. Ex. 1 at 25.

qualified to manage the Four Funds and had ample support in selecting investments for them.[10] Further, many of the Four Funds' investments were underwritten by well-regarded Wall Street firms including Deutsche Bank, Credit Suisse, Stifel Nicolaus, Merrill Lynch, Sandler O'Neill and Citibank, *see*, *e.g.*, Tr. 2170:13–2171:2, and the SEC noted as much. Livingston Ex. 103 at 12.[11] Second, MS&Co. acquired KeyCorp Leasing's 12 person due diligence team, Tr. 4546:23–4547:9, who performed the due diligence for the Trust Offerings. Respondents were also well aware of the features, risks and rewards of the Trust Offering based on MS&Co.'s long history in offering such products.

Respondents also knew that their clients were receiving scheduled interest payments until April 2010 when the Receiver was appointed,[12] as Respondents checked client account statements. *See*, *e.g.*, Tr. 4286:11-23. McGinn Smith Securities (alternative investments) were but a small fraction of their clients' portfolios.

II.

RESPONDENTS DID NOT VIOLATE SECTION 5

The Division fails to adequately rebut any of Respondents' arguments why Section 5 liability is unwarranted here.

First, the Division concedes by silence that there can be no actionable Section 5 claim regarding the Four Funds, as Respondents did not sell them after September 23, 2008. Div. Ex. 2; *see also* 28 U.S.C. § 2462.

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10 *See*, *e.g.*, Tr. 1928:25–1929:15, Tr. 3271:11–3272:10; Tr. 2168:2–2169:22, Tr. 4269:13–4271:13.

11 *See also* RMR Exs. 513C, 513D, 514B, 514D, 503F, 502A, 501N, 500B-D, 506E.

12 *See supra* n.3.

Second, the Division admitted that there were fewer than 35 unaccredited investors in each Trust Offering, OIP ¶32, and the ALJ rejected the Division's integration theory of liability. Decision at 96. Further, the financial and non-financial disclosure in the Trust Offerings' PPMs satisfied Rule 502. *See* JB at 27 (citing Div. Ex. 264 at 7); *see also* Div. Ex. 63 at 4-5, 8-9, and Ex. D thereto; Div. Ex. 68 at 6-7, 10-11 and Ex. D thereto.

Third, the prime source of the Division's summary charts, a MS&Co. database, was admitted to be inaccurate by its author, Tr. 1379:8–1380:9 (Sicluna), and secondhand oral information provided to the Division's attorneys years after-the-fact that was contradicted by contemporaneous written representations by investors (*see* JB at 26) was not "better information." Decision at 72 n.90.

Finally, the Division does not dispute that courts and the Commission have only imposed Section 5 liability on an individual registered representative where there was (a) an obvious failure to comply with the registration requirements or with any claimed exemption, *and* (b) knowing or recklessly deceptive conduct by the registered representative – conduct that was not present here. *See* JB at 27.

III.

SECTION 2462 BARS THE CLAIMS ASSERTED IN THE OIP

Section 2462 is clear on its face: "a proceeding for the enforcement of any civil fine, penalty, or forfeiture...shall not be entertained unless commenced within five years from the date when the claim first accrued." 28 U.S.C. § 2462. By charging alleged pre-September 2008 violations in the same proceeding with alleged post-September 2008 violations, the ALJ was without subject matter jurisdiction under Section 2462. There is no exception when the proceeding *also* seeks equitable relief. The Division's attempt to distinguish *Williams v.*

Warden, 713 F.3d 1332 (11th Cir. 2013), because it was interpreting a different federal statute, DB at 4, is unavailing, as the same statutory language was at issue – "shall not be entertained."

Further, and contrary to the Division's mischaracterization, Respondents do *not* contend that Section 2462 immunizes alleged post-September 2008 misconduct. *See* DB at 3. Any misconduct occurring within five years could have been prosecuted, but *not* when the OIP also charged violations before then.[13] The proceeding was thus time barred under Section 2462 because the proceeding sought enforcement of a civil fine, penalty, or forfeiture based on alleged conduct prior to September 23, 2008.

Respondents also maintain that disgorgement here constitutes "forfeiture" and associational bars or suspensions are punitive. Both are subject to Section 2462. JB at 8-9. Notwithstanding the Commission's recent Opinion that industry bars are not subject to *any* statute of limitations, *see Matter of Timbervest*, 2015 SEC LEXIS 3854, at *55 (Sept. 17, 2015), numerous decisions – including several by the Commission – hold otherwise. *See, e.g., SEC v. Bartek*, 484 F. App'x 949, 957 (5th Cir. 2012); *Matter of Eric J. Brown*, 2012 SEC LEXIS 636, at *45 (Feb. 27, 2012). The Division admitted as much in its post-hearing brief, and it should be judicially estopped from now taking a contrary position. *See* Div. Post-Hearing Br. at 37-38.

IV.

RESPONDENTS WERE DEPRIVED OF THEIR EQUAL PROTECTION AND DUE PROCESS RIGHTS AND THE PROCEEDING WAS UNCONSTITUTIONAL

A. Respondents Were Denied Equal Protection

1. The Commission sued McGinn, Smith and others in federal court in April 2010. Despite the interrelated issues between these two proceedings and the allegations in the

13 *See, e.g.*, OIP, ¶39 (Respondents allegedly failed "to conduct a searching inquiry" when the Four Funds were offered during 2003 to 2005), ¶¶61-68 (alleging violations based on purported conduct from 2003).

OIP directed at McGinn and Smith, Respondents were discriminatorily deprived of the benefits of a federal forum that were afforded to McGinn and Smith.[14] The Commission does not have unfettered discretion to select its forum.

2. Respondents' equal protection rights were further violated by singling them out for punishment for McGinn and Smith's secret fraud, even though some 40 other registered representatives also did not see red flags and sold $69 million of McGinn Smith Securities to their customers.[15] The Division's contention that Respondents' customers purchased more McGinn Smith Securities than other registered representatives, says nothing about motive, intent and knowledge. Moreover, prosecutorial discretion is not boundless. Any "presumption" that the Commission properly discharged its duties can be and has been rebutted here.

B. Respondents Were Denied Due Process

1. Respondents were denied due process starting with the group pleading in the OIP[16] which failed to disclose as to each Respondent when material misrepresentations or omissions were allegedly made, to which customers, and about which of the 26 McGinn Smith Securities offered during a 7-year period (2003-2009). Respondents had to guess about the charges against them.

The ALJ compounded the due process deprivation by denying Respondents' separate motions for a more definite statement,[17] which requested this basic information. This was in error. *See, e.g., Matter of Bandimere and Young*, 2013 SEC LEXIS 452, at *5 (Feb. 11,

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14 *Gupta v. SEC*, 796 F.Supp. 2d 503 (S.D.N.Y. 2011).

15 Div. Ex. 591.

16 *See, e.g.,* ¶37 ("The [ten] Respondents also made material misrepresentations and omissions when recommending the Four Funds and Trust Offerings to their customers.").

17 Order on Motions For A More Definite Statement dated December 12, 2013.

2013) ("[i]n light of the number of investors involved, the variety of misrepresentations and omissions potentially at issue, and the fact that the alleged conduct occurred over a period of five years, the investors and potential investors must be identified").

2. Respondents were not afforded an opportunity to be heard "at a meaningful time and in a meaningful manner."[18] The Division had four years to prepare, but Respondents only had four months. The Division's gargantuan investigative file consisting of some 10,000,000 electronic records and 120 boxes of papers – all unindexed and much of which was provided only on the eve of trial – deprived Respondents of "a full and fair opportunity to litigate."[19]

The Division purports to distinguish *Collins*[20] -- which chastised the Division for similar conduct – on the grounds that it described a party's obligations "under the Federal Rules of Civil Procedure...not the Rules of Practice that apply to APs." DB at 9. The Division's argument effectively admits that the Rules of Practice are far more limited than the protections afforded by the Federal Rules of Civil Procedure.[21] That argument is directly contrary to the Commission's recently published Rule revisions and recently announced guidance regarding forum selection.[22] There can be no doubt that this matter – even without it being a surrogate of

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18 *Matthews v. Eldridge*, 424 U.S. 319, 333 (1976).

19 *Locurto v. Guiliani*, 447 F.3d 159, 171 (2d Cir. 2006).

20 *SEC v. Collins & Aikman Corp.*, 256 F.R.D. 403, 410 (S.D.N.Y. 2009).

21 Respondents do not contend that "the Division must produce its investigative files *before* an OIP is issued." DB at 9 (emphasis in original). Respondents' position is that complex cases, such as this one, should be in federal court where there can be adequate time for discovery, among other due process safeguards.

22 Amendments to the Commission's Rules of Practice, Release No. 34-75976, Sept. 24, 2015; Division of Enforcement Approach to Forum Selection in Contested Matters at 4 (2015) ("If similar charges...have been brought against similarly situated parties...in the same or closely related contested matters, it may be preferable to recommend charges against similarly situated parties *in the same forum*.") (emphasis added).

the Commission's action against McGinn and Smith – should *not* have been filed administratively.

The Division asserts that, by agreeing to start the hearing on January 27, 2014, Respondents thereby agreed that they had sufficient time to prepare. DB at 9. Respondents made no such agreement. The hearing was required to commence within four months of the service of the OIP.

3. Despite having more than three years to find witnesses, the Division engaged in a post-OIP investigation to find support for the OIP's naked allegations. The ALJ denied Respondents' separate motions to preclude such witnesses despite Commission Rule 230(g). The Division's argument that its conduct was permissible because it did not serve subpoenas (DB at 15) is simply not supported by Rule 230(g).

Nor is the Division's position supported by *Tilton*. DB at 15. In *Tilton*, respondents received the identity of *all* witnesses the Division contacted *after* OIP was filed. *See Matter of Tilton*, 2015 SEC LEXIS 1773, at *2 (May 7, 2015) (ordering Division to "notify Respondents [Tilton] on a rolling basis...of additional investors that it contacts").

4. Respondents' due process rights were also violated by the Division's conduct in soliciting them to assist the Commission's federal court action against McGinn and Smith, while secretly investigating them. The Division admits that it never provided Respondents with Form 1662 or a Formal Order of Investigation (DB at 14) and concedes by silence that (a) it led Respondents to believe that they were being called solely as non-party witnesses to assist the Division, (b) Respondents did not prepare to respond to questions directed at them and did not have MS&Co. records with which to prepare, and (c) Respondents were never given their non-party deposition transcripts to review, correct, amplify or sign. The Commission's Code of Conduct does not countenance such conduct.[23]

Disturbingly, the Division appears to claim it never has an obligation to provide Form 1662, stating that "Respondents cite no authority for their position." DB at 14. The Division is required to do so. *See* 5 U.S.C. § 552a(e)(3); SEC Enforcement Manual § 3.2.3.1.

5. Respondents' due process rights were further violated by the Division's failure to make timely and complete disclosure of *Brady* material. The Division delayed making any *Brady* disclosure until January 6, 2014, a few weeks before the hearing began, and the disclosure was incomplete. For example, the Division first contacted Mr. Strawbridge in November 2013 and asked whether Respondent Mayer had informed him that he "could lose all of his money" when investing in McGinn Smith Securities. Strawbridge informed the Division that he was fully aware of the risks of those investments. *See* RMR Ex. 606, ¶4. Yet, the Division failed to disclose that conversation in its *Brady* disclosure. *See* RMR Ex. 873. Respondents moved to compel disclosure of all *Brady* material, which was denied. *See* Order on Several Motions dated Jan. 15, 2014, at 4 ("I disagree...that the views of some customers that they were not misled is *Brady* material.").

C. The Administrative Proceeding Was Unconstitutional

Respondents maintain that this administrative proceeding was unconstitutional under Article II of the Constitution because the ALJ is not a mere employee and must be subject to appointment and removal as required by the Constitution. U.S. Const. Art. II § 2, Cl. 2. *See* JB at 33. Respondents are aware of the Commission's recent Opinions in *Timbervest* and *Lucia*

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23 *See* Enforcement Manual §§ 1.4.1, 1.4.4.

(including the dissent).[24] Respondents rely on *Free Enterprise*, *Freytag*, *Hill*, *Gray Financial*, and *Duka* as support for their position that the administrative proceeding was unconstitutional without reiterating points the Commission recently considered and rejected.[25]

V.

THE ALJ WAS BIASED AND MADE PREJUDICIAL RULINGS

1. The Division's suggestion (*see* DB at 11-12) that the ALJ was a neutral, unbiased arbiter is belied by the record. *See* JB at 31. The ALJ's refusal to allow Respondents to file a motion with the Commission challenging subject matter jurisdiction under Section 2462, because she did not want to "second guess[]" the Commission's decision to hear the case, underscores the ALJ's prejudgment. Pre-Hearing Tr. (Jan. 21, 2014) at 30:19.

Far from presenting the "appearance of complete fairness," the hearing was infected with bias even before it began. *Amos Treat & Co. v. SEC*, 306 F.2d 260, 267 (D.C. Cir. 1962). During the only prehearing conference held by this ALJ, a week before the hearing began, she stated regarding the allegations in the OIP: "the Commission has a legal basis for thinking they were right," and the Division supported the ALJ's conclusion, stating that the OIP "is reviewed in every nook and cranny of the SEC," as if the alleged violations were incontrovertible. Pre-Hearing Tr. at 31:14–32:1.

During testimony by one Respondent who was explaining why he thought the Four Funds' interest rates were achievable, the ALJ interrupted: "how do you square all that

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24 *Matter of Timbervest*, 2015 SEC LEXIS 3854, at *89-119 (Sept. 17, 2015); *Matter of Raymond J. Lucia Cos., Inc.*, 2015 SEC LEXIS 3628, at *76-90 (Sept. 3, 2015).

25 *Freytag v. Comm'r. of Internal Revenue*, 501 U.S. 868, 880 (1991); *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010); *Hill v. SEC*, 2015 U.S. Dist. LEXIS 74822, at *42-52 (N.D. Ga. June 8, 2015); *Gray Fin. Grp., Inc. v. SEC*, 2015 U.S. Dist. LEXIS 131792, at *34-47 (N.D. Ga. Aug. 4, 2015); *Duka v. SEC*, 2015 U.S. Dist. LEXIS 100999, at *5-8 (S.D.N.Y. Aug. 3, 2015).

with...the letter that evidently Smith wrote in 1999 that said the whole thing was a sham...how do you square that the person that is running the operation wrote this in 1999 and your representation that the debt was this and this, and this was coverage and everything was great? I mean there is two completely opposite things." Tr. 5703:22–5704:8.

The Division convinced the ALJ to receive into evidence, over Respondents' objections,[26] the 1999 *never-sent* letter from Smith – pure hearsay, filled with prejudicial statements, and relied upon by the ALJ – claiming that the letter was "used as evidence in the criminal trial" of McGinn and Smith. *See* Tr. 4574:24-25.

Once admitted,[27] the Division read prejudicial and inflammatory portions of the 1999 letter into the record during the testimony of Mary Ann Cody, *see* Tr. 4577:21–4580:25, and then asked, "[D]oes that ring a bell as consistent with what you remember happening around that time, '99, 2000?" Tr. 4582:11-14. Reading the letter into the record "under the guise of asking questions" is precisely what the Second Circuit found to be "manifestly erroneous," and "especially prejudicial and improper" in McGinn and Smith's criminal trial. *See United States v. McGinn*, 787 F.3d 116, 128 (2d Cir. 2015). The prejudicial effect of the ALJ's admission of the 1999 letter here is undeniable. Given the ALJ's comments (i.e., "how do you square all that with...the letter that Smith wrote in 1999 that said the whole thing was a sham"), the admission of the 1999 letter alone requires dismissal as the entire hearing was indelibly tainted by it.

"A fair trial in a fair tribunal is a basic requirement of due process." *In re Murchiron*, 349 U.S. 133, 136 (1955). Respondents were denied a fair trial.

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26 Tr. 4575:5-11, 4577:20.

27 The Division pre-marked the 1999 letter as its Exhibit 350, but introduced into evidence, over Respondents' objections, Livingston Exhibit 31 (handwritten 1999 letter) and Livingston Exhibit 32 (version typed by U.S. Attorney). Tr. 2948:12-19.

CERTIFICATE OF COMPLIANCE

This brief complies with the Commission's Extension and Word Limit Order, dated June 5, 2015. The brief contains 4,998 words, exclusive of the Table of Contents, Table of Authorities, Signature Blocks, and this Certification, as counted by Microsoft Word, the word processing system used to prepare it.

Dated: New York, New York
October 28, 2015

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October 28, 2015

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VIA FEDERAL EXPRESS

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549

Re: *In the Matter of Donald J. Anthony, Jr., et al.,*
Administrative Proceeding File No. 3-15514

Dear Mr. Fields:

We enclose an original and three copies of the Joint Reply Brief Addressing Certain Legal Issues In Accordance With The Commission's Order. Please note that, with the authorization of the other Respondents' counsel, we have signed the Joint Reply Brief on their behalf. We have also enclosed a Certificate of Service.

Sincerely,

M. William Munno

M. William Munno

Enclosures

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SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15514

In the Matter of

DONALD J. ANTHONY, JR.,
FRANK H. CHIAPPONE,
RICHARD D. FELDMANN,
WILLIAM P. GAMELLO,
ANDREW G. GUZZETTI,
WILLIAM F. LEX,
THOMAS E. LIVINGSTON,
BRIAN T. MAYER,
PHILIP S. RABINOVICH, and
RYAN C. ROGERS,

Respondents.

CERTIFICATE OF SERVICE

I hereby certify that on October 28, 2015, I filed an original and three copies with the Office of the Secretary of the Commission via Facsimile and Federal Express, and that on October 28, 2015, I served the enclosed Joint Reply Brief Addressing Certain Legal Issues In Accordance With The Commission's Order via Federal Express and email on:

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