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UNITED STATES OF AMERICA
Before the
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.

RESPONDENT THOMAS LIVINGSTON'S SUPPLEMENTAL BRIEF TO THE COMMISSION

Pursuant to the Commission's April 23, 2018 Order, Respondent Thomas Livingston ("Livingston") files this Supplemental Brief. On March 30, 2018, ALJ Murray issued an Order Revising and Ratifying her February 25, 2015 Initial Decision ("Ratification Order"). Except for limiting Livingston's permanent bar to association with a broker-dealer, as required by *Bartko v. SEC*, 845 F.3d 1217 (D.C. Cir. 2017), ALJ Murray "ratified" her original findings and sanctions against Livingston. ALJ Murray's Initial Decision, as revised and ratified, should be reversed by the Commission for the reasons stated below, in prior briefings, and at oral argument before the Commission. Pursuant to the Commission's April 23rd Order, this Supplemental Brief is not intended to address all reasons why ALJ Murray's decisions should be reversed, but rather highlights a selected few critical issues for the Commission to consider.

A. The ALJ Erred in Applying the Statute of Limitations

At issue in this case were two different offerings: 1) the "Four Funds," offered from 2003 to early 2008 and 2) the later "Trust Offerings." The vast majority of the Division's case, and ALJ Murray's Initial Decision, focused on the Four Funds. However, the only securities sold by Livingston during the limitations period (after September 23, 2008) were four sales of Trust Offerings to three individuals.

ALJ Murray inappropriately relied upon her findings as to the Four Funds as the basis for finding violations related to separate sales of Trust Offerings. Indeed, in her Ratification Order, ALJ Murray re-states that she found Respondents "had the requisite scienter to violate the provisions of the securities law by February 1, 2008" and "continued to recommend and sell the fraudulent products after September 23, 2008." Ratification Order at 11. However, ALJ Murray fails to note that Livingston did not sell any Four Fund investments after January 2007, more than a year before she claims Livingston allegedly had "scienter," or that he did not sell any of the relevant Trust Offerings before February 2008. According to ALJ Murray's own reasoning, the SEC's claims first accrued prior to September 23, 2008 and, therefore, would be entirely barred. ALJ Murray also provides no rational explanation how scienter related to earlier Four Fund sales is relevant to later sales of distinct Trust Offerings in October 2008, which according to the Division's own expert, "were not at all similar" to the Four Funds. Div. Ex. 1 at 25.

The Four Funds were designed to make loans to individual companies and to generate revenue based on loan payments. In contrast, Trust proceeds were used to directly purchase assets and revenue streams from specific purpose entities, usually related to long-term contracts for burglar alarm service, "triple play" (broadband, cable and telephone) service, or luxury cruise cabin bookings. Initial Decision at 7. The Trust Offerings were like the pre-Four Funds notes offered by MS&Co., for which the firm a "national reputation." *Id.* at 3.

Importantly, unlike with the Four Funds, the shortcomings with the Trust Offerings were not the result of alleged undisclosed investments and conflicts; rather McGinn and Smith stole Trust funds and falsified accounting records to cover their tracks. *See, e.g., Securities Exchange Commission v. McGinn, Smith & Co., Inc., et al.*, Memorandum-Decision and Order, No. 1:10-cv-00457-GLS-CFH, at 10-11 (Feb. 17, 2015) (hereinafter, "MDO I") at 31 (McGinn and Smith used the Trust Offerings "to structure a series of transactions that would allow various McGinn Smith Entities to siphon off millions of dollars in transaction fees and commissions…"). There was no evidence that Livingston or any other respondent had any clue about the embezzlement by McGinn and Smith and nothing about the Four Funds would have alerted respondents of potential later theft of investor money. Nothing on the face of the Trust Offerings was improper. Instead, monies raised were invested in the specific streams of receivables and disclosed assets as promised, including the purchase of contracts for security alarm services, broadband cable services, telephone services, and luxury cruises. *Id.* at 13-14. In looking at TDM offerings in hindsight with forensic review of its financial statements and operations, the SEC court-appointed receiver's opinion was that its underwriting was poor. The receiver admitted that there was no evidence that the brokers were aware of the poor underwriting. FoF 37-40.

ALJ Murray improperly attempts to conflate the Four Funds and Trust Offerings to avoid the clear statute of limitation issues. The Trust Offerings were wholly different securities and were not "fraudulent" by reason of the earlier Four Funds. The ALJ was required, but failed to, analyze the Trust Offerings separately. The ALJ's claim of a continuing violation is wholly without merit and, therefore, the Commission should find that the claims against Livingston are time-barred.

B. There is No Evidence to Support Fraud Findings for Livingston's Few Sales After September 23, 2008

In addition to the statute of limitation issues, there is no evidence to support the ALJ's findings of fraud against Livingston related to the few sales that occurred after September 23, 2008. Livingston made four sales of a Trust Offering to three customers after September 23, 2008. Those investments totaled $255,000 for which Livingston allegedly received a total of $700 in commissions.[1]

The only alleged wrongdoing found against Livingston related to the Trust Offerings is the ALJ's claim that he failed to advise two of his clients, Messrs. Ferris and LaFleche, about the

[1] As set forth in his Motion to Correct the Initial Decision, the $700 "commission" did not relate to a sale of a trust offering. Without any support, the ALJ blindly accepted a Division employee's claim that the payment for "Net Private 70%" on a schedule was for a sale of TDMM Cable 09, despite no evidence connecting the two.

issues with their Four Fund investments prior to their Trust Offering purchases.[2] Initial Decision at 104.

First, ALJ Murray never addressed why Livingston would defraud Ferris and LaFleche, who were at the time his two best friends, especially when Livingston headed the firm's syndicate department, was not a retail broker, and did not stand to financially benefit from their investments. *See* Hr'g Tran. at 46:17-19. Livingston simply had no reason to defraud his two best friends and a finding that he did defies logic and the evidence.

Second, the evidence shows that Ferris and LaFleche were aware of the problems with their Four Fund investments before they purchased the Trust Offerings at issue. Incredibly, the ALJ wholly ignored – twice now – three separate letters sent to both Ferris and LaFleche throughout 2008, before either made a purchase of a Trust Offering at issue, that detail the severe liquidly issues of the Four Funds. In fact, before either invested in a Trust Offering in 2008, both Ferris and LaFleche were told, initially, that their interest payments were cut by more than half, then later, that their interest payments were being suspended entirely, and finally, that the maturities on their investments were being extended from 5 years to 20 years and the interest permanently reduced. *See* Livingston Findings of Fact 74-75, 80-82; Div. Ex. 132, 188, and 193. More incredibly, both Ferris and LaFleche admitted to being told by Livingston personally that their investments in the Four Funds were in trouble, but ALJ Murray also ignored this testimony. Hr'g Trans. at 43:15-18; Initial Decision at 47.

[2] The third client who purchased a Trust Offering did not testify at the hearing. The ALJ claimed that Mr. Livingston "did not mention any financial problems at MS & Co." in connection with William Carroll's purchase of TDMM Cable on June 9, 2009. Initial Decision at 46. Livingston did not testify that he "did not mention any financial problems at MS & Co." Instead, Mr. Livingston testified that he did not discuss the liquidly issues concerning the Four Funds that he noted in his December 2007 memorandum. Hr'g Tr. at 5339-40. Mr. Carroll had not invested in the Four Funds and Mr. Livingston's concerns about the performance of the Four Funds had no relevance to Mr. Carroll's purchase in June 2009 of a trust investing in triple-play contract receivables. *Id.*

Put simply, Messrs. Ferris and LaFleche were keenly aware of the severe financial distress of their Four Fund investments prior to investing in the Trust Offerings. Accordingly, the entire basis of the ALJ's decision against Livingston related to the post-September 2008 sales ignores the undisputed evidence of disclosure to investors. Accordingly, the findings of fraud against Livingston must be reversed.

C. The Permanent Bar Against Livingston Must be Overturned

Putting aside Livingston's objection to pre-September 2008 findings, there is no evidence that Livingston committed fraud within the applicable statute of limitations. There was no evidence or findings of any alleged misrepresentations. As for alleged omissions, as shown above, the ALJ completely ignored the disclosures made to investors. Moreover, the evidence does not support that Mr. Livingston acted with scienter and, therefore, a permanent bar is not warranted. *Steadman v. SEC*, 603 F.2d 1126, 1141 (5th Cir. 1979) ("It would be a gross abuse of discretion to bar a [financial professional] from the industry on the basis of isolated negligent violations.").[3]

ALJ Murray upheld the portion of her Initial Decision in which she found that she could rely on conduct outside the statute of limitations in imposing a bar. ID at 2, fn 2; *but see In the Matter of the Application of Eric J. Brown*, SEC Release No. 3376, 2012 WL 625874 (2012); *In the Matter of Edgar B. Alacan*, SEC Release No. 8436, 2004 WL 1496843 (2004); *In the Matter of Feeley & Wilcox Asset Mgmt. Corp.*, SEC Release No. 2143, 2003 WL 22680907 (2003). Accordingly, ALJ Murray admittedly improperly relied upon alleged pre-September 23, 2008 conduct to impose a bar against Livingston.

[3] To the extent that the bar was based on Section 5 violations, there was no finding of scienter with regard to those violations nor was there any evidence that Mr. Livingston was aware or should have been aware that the offerings were not subject to an exemption from registration. Mr. Livingston reasonably relied on the representations of the issuer, the Funds' advisor (Smith), the MS&Co. compliance department, and outside counsel regarding the legality of the offering. TL Ex. 1, 2, 17, 60. Mr. Livingston was not aware that any of the offerings exceeded 35 unaccredited investors. Hr'g Tr. 5237:3-21.

Moreover, ALJ Murray failed to make meaningful, individualized findings to support the bar imposed against Livingston, as she was required to do. *Steadman*, 603 F.2d at 1139; *see also McCarthy v. SEC*, 406 F.3d 179, 189 (2nd Cir. 2005); *Monetta Fin. Servs, Inc. v. SEC,* 390 F.2d 952, 957 (7th Cir. 2004). The ALJ merely recites the *Steadman* factors and then discusses them in broad terms as applied to all respondents, even penalizing respondents for arguing the unknown fraud committed by the two McGinn Smith principles as a mitigating factor. Initial Decision at 112-113. ALJ Murray did not attempt to cure this defect in her Ratification Order. More importantly, ALJ Murray provides no basis for issuing a permanent bar against Livingston, while suspending for one year most other respondents.

Each of the selling Respondents, except Gamello, were all found to be liable for the same violations of the federal securities laws, with the same level of scienter, and each received the same monetary penalty ($130,000). Initial Decision at 93-109. Yet, Mr. Livingston was permanently barred, while most others were suspended for one year. *Id.* at 113. The only others permanently barred was a respondent who defaulted and Lex, who is no longer in the securities business. The ALJ provided no justification for such inequitable treatment, nor is there a rational reason to punish Mr. Livingston more than the others. *Id.* Indeed, Mr. Livingston made sales to three customers totaling $255,000 after September 23, 2008 (the relevant statute of limitations period) for which he allegedly received a total of $700 in commissions. Only Feldmann (who settled) and Guzetti (an alleged supervisor) had fewer sales during the relevant time period.

The ALJ further completely ignored all mitigating factors. The ALJ failed to consider that Mr. Livingston has had not one customer complaint, including from the investors who testified against him, in the 9 years since leaving McGinn Smith. The ALJ ignored that Mr. Livingston has never been the subject to regulatory investigation or sanctions, is not allegedly to have engaged in any misconduct since leaving MS&Co., and he is not a threat for repeat offense because he is not a retail broker -- he deals exclusively with underwriting SEC-registered securities in transaction primarily led by the major banks, including Merrill Lynch, J.P. Morgan Chase, Wells Fargo, and Morgan Stanley. Hr'g Tr. 5176:8-14. The bulk of the transactions in which Mr. Livingston is involved are fixed income securities, such as preferred stocks issued by large companies, and structured products that are FDIC insured. He is not involved in underwriting or selling unregistered securities, including private placements. Hr'g Tr. 5174:6 - 5176:7.[4] In her Ratification Order, ALJ Murray rejected similar arguments, finding that mere continuation in the securities business was sufficient to find likelihood of future violations. Ratification Order at 19-20. Under such reasoning, no respondent seeking to avoid a suspension or bar would ever favorably survive a *Steadman* analysis.

The ALJ's decision to end Mr. Livingston's 40-year career--which focuses exclusively on the syndication of registered securities underwritten by major investment banks--over four sales for which Mr. Livingston received at most $700 in total commissions is arbitrary and capricious. While no bar or suspension is appropriate, at a minimum, Livingston should not receive anything longer than a one-year suspension like similarly situated respondents. Anything more is arbitrary and capricious and not based on alleged conduct within the applicable statute of limitations.

[4] The ALJ also ignored several undisputed facts about Mr. Livingston, which she nevertheless highlighted to conclude that Gamello did not violate the anti-fraud provisions of the federal securities laws. Initial Decision at 101-02. Just like Gamello, except for a single sale, all of Mr. Livingston's Four Fund sales occurred shortly after the Funds began -- all FAIN sales were within first 3 months it was offered; all TAIN sales, save one, were within first 8 months of the offering; all FIIN sale were within first 6 months, and only FEIN sale was within the first 6 months. Div. Ex. 2 at 108. Moreover, just like Gamello, Mr. Livingston did not sell any Four Funds after December 2007 -- in fact, his last sale was in January 2007. *Id.* And, just like Gamello, Mr. Livingston did not sell any of the Trust Offerings after August 2009 -- his last sale was in June 2009. *Id.* It was arbitrary and capricious for the ALJ to apply one set of rules for Gamello, while ignoring the same facts as to Mr. Livingston.

D. The Fatal Constitutional Issues Have Not Been Cured by the Ratification Process

The Commission's purported re-appointment of all ALJs and the ratification process the resulted from the Solicitor General's position in *Raymond J. Lucia v. SEC* does not cure the fatal constitutional violations here. However, because the Commission has formed its position on these issues, we address these in summary.

As the United States agreed in *Lucia*, SEC ALJs are inferior officers, subject to the Appointments Clause. SEC ALJs must be appointed by the full Commission. There is no evidence of an original appointment of ALJ Murray such as the signature and delivery of a commission. *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 157 (1803); see U.S. Const. art. II, § 3 (requiring "all the officers of the United States" to receive a commission). Accordingly, the Commission's purported November 30, 2017 "ratification" of ALJ Murray's appointment was a nullity.

Moreover, the Commission's direction for ALJ Murray to reconsider her own prior decision was error. Livingston was, at a minimum, "entitled to a hearing before a properly appointed [ALJ]." *Ryder v. United States*, 515 U.S. 177, 188 (1995); *see also United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 38 (1952). A cold, re-review of a massive record by the same ALJ, who was not properly appointed, does not replace Livingston's right to a live hearing before a constitutional tribunal. ALJ Murray was an SEC employee, not a properly appointed officer, when she drastically shaped the administrative record in this case. The Commission cannot legitimately expect that ALJ Murray would provide a fair and balanced review of her own findings. Nor did she even attempt to do so. There is no evidence that ALJ Murray reviewed the entire record, including the factual and legal issues raised by Livingston in prior briefing, as not one of those issues was addressed in the Ratification Order. The Commission must either dismiss this proceeding in its entirety or seek a new hearing before a properly appointed ALJ, other than ALJ Murray, or a federal district judge.

CONCLUSION

For these reasons and for the reasons set forth in prior briefing and argument, Livingston respectfully requests that the Commission reverse the Initial Decision and dismiss all claims against Livingston.

Dated: May 21, 2018

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CERTIFICATE OF SERVICE

I hereby certify that on the date set forth below, I filed this document with the Office of the Secretary of the Commission via facsimile and contemporaneously sent via Federal Express the original and three copies and served copies on the following persons via Federal Express and email.

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