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.

**PHILIP S. RABINOVICH'S AND BRIAN T. MAYER'S SUPPLEMENTAL REPLY BRIEF REGARDING THE LAW JUDGE'S 2018 DECISION**

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In accordance with the Commission's Order dated May 31, 2018, Respondents Philip S. Rabinovich and Brian T. Mayer submit this brief in response to the Division's Supplemental Reply Brief dated June 4, 2018 ("Div. Br."), regarding the law judge's 2018 Decision.[1]

Rather than submit an initial supplemental brief of its own on May 21, 2018 addressing the 2018 Order (as all Respondents did pursuant to Commission Order),[2] the Division opted instead to await receipt of Respondents' supplemental briefs and respond to those arguments in a subsequent submission. The Division's "reply," however, ignores numerous errors and infirmities in the 2018 Order that were raised by Rabinovich and Mayer, including:

(1) Rabinovich and Mayer made no material misrepresentations or omissions to any client about any McGinn Smith Security (*see* Rabinovich Br. at 2-5; Mayer Br. at 2-5);

(2) Rabinovich and Mayer acted prudently and fulfilled their duties as registered representatives (*see* Rabinovich Br. at 5-6; Mayer Br. at 5-6);

(3) Rabinovich and Mayer were not reckless in selling Trust Offerings based on supposed red flags relating to a different investment product – the Four Funds (the sale of which predated the OIP by more than five years) (*see* Rabinovich Br. at 4-5; Mayer Br. at 4-5);

(4) The law judge did not meaningfully reexamine the *Steadman* factors and ignored that the vast majority of alleged misconduct in the OIP occurred prior to September 23, 2008 (*see* Rabinovich Br. at 6-8; Mayer Br. at 6-7);

(5) Rabinovich and Mayer may not and should not be collaterally suspended from association with an investment adviser based solely on alleged conduct in their capacity as registered representatives of a broker-dealer that occurred

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1 Capitalized terms not otherwise defined herein shall have the meaning given to them in the supplemental briefs filed by Rabinovich ("Rabinovich Br.") and Mayer ("Mayer Br.").

2 *See* Order dated April 20, 2018 (directing Respondents and the Division to submit "simultaneous briefs" on May 21, 2018 addressing "any matters they deem pertinent" in the 2018 Order).

prior to the passage of the Dodd Frank Act in July 2010 (*see* Rabinovich Br. at 7-9; Mayer Br. at 8-9);

(6) Neither the law judge nor any other forum had jurisdiction to hear any of the claims because more than half of them arose more than five years before the OIP was filed – that is before September 23, 2008 (*see* Rabinovich Br. at 10-12; Mayer Br. at 10-11);

(7) The law judge erred in admitting David Smith's never-sent 1999 handwritten letter, pure hearsay and filled with prejudicial statements (*see* Rabinovich Br. at 14-15; Mayer Br. at 13-14);

(8) The law judge erred in excluding affidavits from Rabinovich's and Mayer's investors (and others) who were subpoenaed to testify, but unable to attend the hearings (*see* Rabinovich Br. at 15-16; Mayer Br. at 15-16); and

(9) The law judge did not reexamine the litany of equal protection and due process deprivations that infected this proceeding since its inception (*see* Rabinovich Br. at 16-18; Mayer Br. at 16-18).

Insofar as it responded at all to the submissions made by Rabinovich and Mayer, the Division ignores controlling law, misrepresents the evidentiary record, and is simply wrong as a matter of law. Accordingly, the Commission should dismiss all charges against Rabinovich and Mayer.

**1. Rabinovich and Mayer Complied With Their Duties As Registered Representatives**

Any reasonable and objective review of the record demonstrates that Rabinovich and Mayer complied with their duties and obligations as registered representatives. Rabinovich and Mayer did not blindly recommend securities or make material misrepresentations or omissions to their investors, but instead engaged in a detailed and thoughtful analysis before recommending only those investments that were suitable for their clients. *See* Rabinovich Br. at 2-6; Mayer Br. at 2-6; *see also* FoF ¶¶ 188-234, 360-415 (Rabinovich), ¶¶ 235-79, 416-78 (Mayer). Their understanding of their customers and the products they recommended is beyond dispute, and this was clear from the testimony of their investors, including those witnesses called by the Division. *See, e.g.*, Mayer Br. at 2-3 (recounting the testimony of Division witness Gary

Von Glinow who described how he and Mayer would review PPMs prior to investing to discuss the structure of the investment, how it worked, how it would pay off, and the risks of investing).

The Division nevertheless proclaims that there is "substantial evidence" that "each Respondent, at a minimum, recklessly failed to investigate in the face of red flags and made customer recommendations with no reasonable basis." Div. Br. at 13. Yet, as to Rabinovich and Mayer, the Division states only that they "knew that customers were being redeemed with new investor funds." *Id.* This argument fails for several reasons.

First, Rabinovich and Mayer were unaware of any purported "redemption policy," pursuant to which clients could redeem their investment in a Four Funds note only if brokers first found a replacement investor. Nowhere in the Division's nearly 400 exhibits is any email or document that demonstrates otherwise. *See* FoF ¶¶ 329-37. Second, the law judge correctly concluded that "[t]he preponderance of the evidence does not support the claim that MS&Co. had a redemption policy that was, in these circumstances, a red flag that warranted investigation." 2015 Decision at 93. Third, following the issuance of the Post Hoc Ratification Order, the Division expressly requested that the law judge "ratify and affirm *all prior actions*," which necessarily includes her finding that there was no "redemption policy." *See* Division Letter to ALJ Murray dated Jan. 19, 2018, attaching Proposed Order. The Division is thus estopped from arguing that a non-existent redemption policy can form the basis for liability against Rabinovich and Mayer.

Nor is liability appropriate based on the cases cited by the Division, which are not remotely similar to the facts here. *See* Div. Br. at 12. For example, in *SEC v. CKB168 Holdings, Ltd.*, 210 F. Supp. 3d 421 (E.D.N.Y. 2016), the founder and promoters of "CKB," a "multi-national pyramid scheme" solicited investors through, among others, seminars, conferences, and

internet postings on sites such as YouTube, and repeatedly made false representations to investors, including that (i) CKB was a legitimate company that would soon go public, and (ii) the "profit reward points" purchased by investors had a cash value of $750 and could be converted to stock. 210 F. Supp. 3d at 427, 441. Similarly, *Matter of Bernerd E. Young*, 2016 SEC LEXIS 1123 (Comm'n Op. Mar. 24, 2016) (*see* Div. Br. at 12), involved numerous false and misleading statements by an individual regarding the multi-billion dollar Ponzi scheme carried out by Robert Allen Stanford. Among other things, the respondent "engaged in egregious and repeated violations throughout his years at the Firm," "approv[ed] false and misleading reassurances in response to red flags," and "played a central role in maintaining the legitimacy necessary to perpetuate Stanford's scheme for several years." 2016 SEC LEXIS 1123 at *90.

There is no evidence that Rabinovich or Mayer made material misrepresentations or omissions to their clients, and the McGinn Smith Securities they sold (a mere fraction of their clients' overall portfolios) were not "fraudulent," despite the Division's insistence on repeatedly uttering this falsity. *See* Div. Br. at 1. The overwhelming evidence demonstrated that, like the SEC, the NASD/FINRA, an outside compliance firm, and approximately 40 other registered representatives who sold more than $69 million of McGinn Smith Securities (and were not charged), Rabinovich and Mayer were unaware of, and unable to detect, the secret theft and diversion of funds by McGinn and Smith (with the aid of inside and outside accountants). Nevertheless, Rabinovich's and Mayer's actions were consistent with NASD Rule 3210(a) (the operative rule during the relevant time period), and consistent with the Second Circuit's decision in *Hanly*, the centerpiece of the Division's theory of liability. *See Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969) (holding that a broker "cannot recommend a security unless there is an adequate and reasonable basis for such recommendation").

## 2. Rabinovich's and Mayer's Constitutional Arguments Are Supported By Supreme Court Precedent

### a. Ratification Was A Nullity And A New Proceeding Was Required

In arguing that ratification is an can cure the constitutional violation here, the Division simply rehashes the same cases that have been cited in mantra-like fashion in virtually all submissions made by Division staff in cases subject to the Post-Hoc Ratification Order and in virtually all resulting decisions issued by the Commission's ALJs. *See* Div. Br. at 4-5. As noted by Rabinovich and Mayer (and ignored by the Division), none of those cases involved the improper appointment of a judge overseeing the principal legal and fact-finding stage of proceedings, but instead the ratification of administrative decisions entirely distinct from judicial or quasi-judicial decision-making. *See* Rabinovich Br. at 12-13; Mayer Br. at 12. The Division does not address these obvious distinctions from the facts presented here.

The Supreme Court's decision in *Edmond v. United States*, 520 U.S. 651 (1997), cited in the Division's recent submission (Div. Br. at 5), is equally inapplicable. The sole question in *Edmond* was whether "Congress has authorized the Secretary of Transportation to appoint civilian members of the Coast Guard Court of Criminal Appeals, and if so, whether this authorization is constitutional under the Appointments Clause of Article II." 520 U.S. at 653. In *Edmond*, civilian members of the Coast Guard Court of Criminal Appeals were initially assigned to the court by the General Counsel of the Department of Transportation. *Id.* Anticipating that these assignments may violate the Appointments Clause, the Secretary issued a memorandum "adopting" the General Counsel's assignments as "appointments of [his] own." *Id.* at 654. Unlike here, the improperly appointed judges did not hear the appeals of the *Edmond* petitioners until *after* the Secretary's memorandum was issued. *Id.* at 655. That the Supreme Court in *Edmond* did not require a new hearing is thus unsurprising. But, insofar other individuals were

subject to hearings *before* the Secretary's memorandum was issued – a scenario similar to that of the instant case – the Supreme Court in *United States v. Ryder* determined that they *were* "entitled to a hearing before a properly appointed panel of" the court. 515 U.S. 177, 188 (1995).

The Division ignores *Ryder* and two other Supreme Court cases cited by Rabinovich and Mayer that reached similar conclusions under similar circumstances. *See* Rabinovich Br. at 9-10; Mayer Br. at 9-10 (citing *Ryder v. United States*, 515 U.S. 177 (1995); *United States v. L.A. Trucker Truck Lines, Inc.*, 344 U.S. 33 (1952); *Wong Yang Sung v. McGrath*, 339 U.S. 33 (1950)). As each of those cases held, where an individual is subjected to an unconstitutional proceeding – a fact now admitted by the Commission in *Lucia v. SEC* – a new proceeding is required.

The Division nevertheless claims that the law judge's purported "de novo review of the entire administrative record"[3] transformed this unconstitutional proceeding into a constitutional one, because the 2018 Order was "lengthy" and reflected a "considered approach and thoughtful analysis." *See* Div. Br. at 6. The Division is wrong.

First, the 2018 Order was neither "considered" nor "thoughtful." The law judge dismissed the majority of arguments made by Rabinovich and Mayer without any discussion beyond a cursory footnote. *See* 2018 Order at 6 n.3 (categorically rejecting all arguments raised by Respondents "not addressed above or below"). Those limited arguments that the law judge did address were fraught with error and bias. For example, in purporting to reconsider whether the admission of David Smith's 1999 *never-sent* handwritten ramblings was in error, the law

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[3] Nowhere in the 2018 Order does the law judge state that she has conducted a "de novo" review of the entire administrative record, which consists of more than 6,000 pages of transcripts spanning eighteen days of hearing testimony, nearly 1,000 unique exhibits, and more than 1,000 pages of motions, pre- and post-hearing briefing, findings of fact and conclusions of law and related submissions.

judge ignored the Second Circuit's decision in the criminal cases against McGinn and Smith, which held that admission of the letter was "manifestly erroneous," and "especially prejudicial and improper." *See United States v. McGinn*, 787 F.3d 116, 128 (2d Cir. 2015); *see also* Rabinovich Br. at 14-15; Mayer Br. at 13-14. Not surprisingly, the Division does not attempt to defend this plainly erroneous ruling by the law judge.

Second, ratification cannot, as a matter of law, be employed to salvage an administrative proceeding conducted by an official appointed in violation of the Appointments Clause. To endorse ratification under these circumstances undermines an agency's incentive to comply with constitutional norms and discourages litigants from raising meritorious objections to the hearing and the qualifications of the presiding officer. *See Ryder*, 515 U.S. at 188 (retroactively blessing an adjudication before an unconstitutional judge "would create a disincentive to raise Appointments Clause challenges with respect to questionable judicial appointments").

b. Restrictions On The Removal Of ALJs Violate Separation-of-Powers And Warrant Dismissal

In concluding that the restrictions on removal of Commission ALJs do not violate the Constitution's separation-of-powers principles, the law judge relied on a mechanical application of the Commission's opinion in *Timbervest*, a case that has since been stayed at the Commission's request. 2018 Order at 8. While supportive of the ultimate conclusion, the Division does not appear to defend the law judge's reliance on *Timbervest*. Rather, the Division relies almost entirely on its purported distinction of the Supreme Court's decision in *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010) and the position staked out by the Solicitor General in its brief to the Supreme Court in *Lucia*. *See* Div. Br. at 7-11. This argument is without merit.

The Division does not (and cannot) dispute that Commission ALJs are protected by more than one layer of protection from removal. Thus, they are subject to the bright-line rule set forth in *Free Enter. Fund*, namely that "multilevel protection from removal is contrary to Article II's vesting of the executive power in the President." 561 U.S. at 484. Relying on a footnote in *Free Enter. Fund*, the Division claims that ALJs are different, because they "perform adjudicative, rather than enforcement or policy-making functions." Div. Br. at 10 (citing *Free Enter. Fund*, 561 U.S. at 507 n.10). The Supreme Court, in *Morrison v. Olson*, 487 U.S. 654 (1988), however, rejected a similar theory that the President's removal authority operates less stringently for quasi-judicial and quasi-legislative officers than for officers with "purely executive" functions. *See id.* at 689 ("[T]he President's power to remove an official cannot be made to turn on whether or not that official is classified as 'purely executive.'").

**3. The Commission May Not Impose Disgorgement**

In arguing that the Commission may punitively impose disgorgement – in addition to statutory penalties – the Division ignores the underpinning of the Supreme Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017). *See* Div. Br. at 14. As noted by the Court in *Kokesh*, the Commission previously lacked statutory authority to seek monetary remedies and sought a viable substitute in the form of purportedly equitable disgorgement. 137 S. Ct. at 1640. In 1990, the Commission first became authorized to seek monetary penalties, but nevertheless continued its practice of seeking disgorgement, thus imposing two forms of penalties upon respondents in enforcement proceedings. *Id.* With this backdrop, the Court ultimately held that disgorgement is a penalty subject to the five-year limitations period in 28 U.S.C. § 2462. *Id.* at 1642. Although the Court expressed no opinion on the Commission authority to order disgorgement, *see id.* at 1642 n.3, such a conclusion is a natural extension of the Court's decision as several courts have since noted. *See, e.g.*, *Osborn v. Griffin*, 865 F.3d 417, 470 n.1 (6th Cir.

2017) (Merritt, J., dissenting) (noting that disgorgement "may not even be applicable in SEC contexts for much longer in light of the Supreme Court's recent opinion" in *Kokesh*); *see also SEC v. Premier Links, Inc.*, 2017 U.S. Dist. LEXIS 151170, at *25 n.10 (E.D.N.Y. Sept. 24, 2017) (same), *report and recommendation adopted by* 2018 U.S. Dist. LEXIS 29555 (E.D.N.Y. Feb. 21, 2018).

**4. Pre-Judgment Interest Is Punitive Here**

In arguing that the law judge's award of pre-judgment interest is not punitive, the Division ignores the unique factual circumstances of this case – a multi-respondent hearing first commenced more than a decade after events alleged in the OIP, followed by nearly a month of hearings, and a remand three years later based on the Commission's failure to properly appoint its ALJs. The cases cited by Rabinovich and Mayer hold that interest can be punitive where a respondent is ensnared in prolonged proceedings, particularly where, as here, such delay is attributable to the actions (or inactions) of a plaintiff. *See* Rabinovich Br. at 18; Mayer Br. at 18 (citing *Matter of Jordan*, 2017 FINRA Discip. LEXIS 39, at *72 (Sept. 26, 2017); *Matter of Coxon*, Securities Act of 1933 Release No. 8271, 2003 SEC LEXIS 3162, at *65 (Aug. 21, 2003); *City of Milwaukee v. Cement Div., Nat'l Gypsum Co.*, 515 U.S. 189, 195-96 (1995)).

The Division fails to meaningfully address these cases, instead cherry-picking a quote from *Coxon* about the general purpose of pre-judgment interest on disgorgement. Div. Br. at 15. The Commission in *Coxon*, however, went on to conclude that under the "unique" circumstances of that case – a 10-year lapse in time from the last alleged violation to the Commission's opinion – prejudgment interest should be cut in half. 2003 SEC LEXIS 3162, at *65. Both the law judge and the Commission have expressly noted that this case presents such "unique circumstances." Commission Order dated May 31, 2018, at 2; *see also* 2018 Order at 6 ("This is an unusual situation.").

## Conclusion

The Commission should dismiss all charges against Rabinovich and Mayer.

DATED: New York, New York
June 14, 2018

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## CERTIFICATE OF COMPLIANCE

This supplemental brief complies with the word limit in the Commission's Supplemental Briefing Order dated April 20, 2018. The brief contains 2,937 words, exclusive of the Table of Contents, Signature Block, and this Certification, as counted by Microsoft Word, the word processing system used to prepare it.

Dated: New York, New York
June 14, 2018

M. William Munno

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SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15514

In the Matter of

DONALD J. ANTHONY, JR.,
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BRIAN T. MAYER,
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Respondents.

**CERTIFICATE OF SERVICE**

I hereby certify that on June 14, 2018, I filed an original and three copies of Respondents Philip S. Rabinovich's and Brian T. Mayer's Supplemental Reply Brief Regarding The Law Judge's 2018 Decision with the Office of the Secretary of the Commission via Federal Express, and served a copy of the foregoing document via Federal Express on:

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June 14, 2018

**VIA FEDERAL EXPRESS**

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

Dear Mr. Fields:

We represent Respondents Philip S. Rabinovich and Brian T. Mayer.

We enclose an original and three copies of Philip S. Rabinovich's and Brian T. Mayer's Supplemental Reply Brief Regarding The Law Judge's 2018 Decision. We respectfully request that their brief be posted on the docket. We also enclose a Certificate of Service.

We appreciate the Commission's attention to this reply brief.

Respectfully submitted,

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