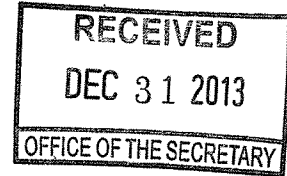


UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15526

In the Matter of

GEORGE B. FRANZ, III

and

RUBY CORPORATION,

Respondents.

MOTION OF RESPONDENTS GEORGE B.
FRANZ, III AND RUBY CORPORATION FOR
SUMMARY DISPOSITION

Your father is just as much of a victim as anybody else here, too. I don't think he even cares about the money. His reputation, I'm sure, was everything to him...Good luck on that, especially when your father works a lifetime to build up a good name and reputation. And that's all we have, all of us when we go to our graves. The only thing that we have is our reputation.

Judge Christopher A. Boyko at Sentencing of Andrew Franz, *United States of America v. Andrew Franz*, United States District Court, Northern District of Ohio, Case No. 1:13CR331, October 23, 2013. Exhibit 1, p. 34.

Now come the respondents, George B. Franz, III ("*George Franz*") and Ruby Corporation ("*Ruby*") (George Franz and Ruby are collectively referred to herein as the "*Respondents*"), by and through counsel, and hereby move for summary disposition pursuant to Rule 250 on the Order Instituting Administrative and Cease-and-Desist

Proceedings (the “*OIP*”) initiated by the Securities and Exchange Commission (the “*Commission*”).

OVERVIEW

The Commission has filed this action against George Franz, the father, for the sole conduct of Andrew Franz, the son. This aggressive strategy accuses Andrew Franz’s primary victim of regulatory violations and a failure to supervise, even though George Franz had nothing to gain from the frauds, has personally lost hundreds of thousands of dollars, and is now watching his business teeter on the precipice of collapse. George Franz accepts that his son was a thief, and he is prepared to make his customer victims whole. Contrary to the Commission’s accusations of conspiracy and concealment, George Franz, without the benefit of insurance, initiated the investigation of Andrew and has repeatedly and voluntarily agreed to pay full restitution to all Ruby customer victims. To date George Franz has paid over \$135,000, and has pledged to pay the balance as funds become available. As such, all other claims of the Commission and prayers for relief against Respondents should be dismissed.

I. STATEMENT OF THE FACTS

Since 2011 overlapping investigations have been initiated by the Commission, the Ohio Department of Commerce, Division of Securities (“*ODOC*”), the Financial Industry Regulatory Association (“*FINRA*”), the United States Attorney for the Northern District of Ohio (“*AUSA*”), the United States Department of the Treasury Internal Revenue Service (“*IRS*”), the Federal Bureau of Investigation (“*FBI*”), and the Cuyahoga County Prosecutor (“*County Prosecutor*”) regarding the actions of Andrew Franz (“*Andrew*”).

The following facts are drawn from matters of public record in:

In re. Andrew J. Franz, Financial Industry Regulatory Authority, Letter of Acceptance Waiver and Consent No. 2010025073601;

In the Matter of Andrew J. Franz, Securities and Exchange Commission, File No. 3-14960;

In the Matter of Ruby Corporation, Securities and Exchange Commission, File No. C-07875;

Securities and Exchange Commission v. Andrew Franz, United States District Court, Northern District of Ohio, Case No. 5:12-cv-00642;

State of Ohio v. Andrew Franz, Cuyahoga County Court of Common Pleas, Case No. CR-12-559575-A; and

United States of America v. Andrew Franz, United States District Court, Northern District of Ohio, Case No. 1:13CR331.

George Franz is a 71 year-old Registered Investment Advisor. He has worked in the financial industry for over 30 years. Ruby is George Franz's company with a portfolio of approximately 100 clients and \$20,000,000 in assets under management.

In 1966 George Franz married Marie Franz and they had three children: Andrew, Deborah, and Rachel. George was an athlete and played baseball with the Pittsburgh Pirates organization from 1961 to 1965. After leaving baseball, George held several positions before ultimately joining Equitable in 1974, where he rose through the ranks and eventually led sales among all District Managers in the United States. George Franz remained with Equitable through 1989.

Andrew followed in his father's athletic footsteps and played high school football at Walsh Jesuit High School. In his sophomore year Andrew received a full football scholarship to The Ohio State University.

[REDACTED]
[REDACTED]
[REDACTED]. Andrew completed 3 ½ years at The Ohio State University and before finishing his degree at Cleveland State University.

Marie Franz died in 2001 of glioblastoma, an aggressive form of brain cancer.

Following college, Andrew Franz followed his father into business. In 1992 Andrew became a Ruby employee. In 2002 Andrew earned a Series 6 registration. From 2002 through 2011 Andrew Franz was registered with and supervised by several broker-dealers, including: Allegheny Investments, Ltd. (2002-2005); Questar Capital Corporation (2005-2006); Sigma Financial Corporation (2006-2007); Fortune Financial Services, Inc. (2008-2010); and H. Beck, Inc. (2010-2011).

George Franz trusted his only son completely and worked hard to supervise and bring him along slowly in the company. George Franz employed Andrew Franz for ten years (1992-2002) before Andrew became a registered representative. Subsequently, Andrew Franz was a registered representative supervised by several broker-dealers for nine years (2002-2011). According to the OIP, Andrew Franz was in the financial services industry for 14 years (1992-2006) when he began committing wrongful conduct by taking checks that properly belonged to Ruby, his father's company.

In 2007 George Franz married Colleen Raborn. He also purchased a second home in Florida, started transitioning his business to Andrew, and was looking forward to retirement.

In 2010 George began to develop concerns about Andrew. Initially, George Franz noticed improper transactions in fees belonging to Ruby and the accounts of the Marie Franz Trust -- a family trust that was not a Ruby client and of which Andrew was one of beneficiaries. George Franz addressed his concerns with Andrew and believed that all matters were resolved. However, out of caution, George Franz started limiting his time in Florida and increased his oversight of Andrew. Over a period of several months in 2011 George Franz discovered more of his son's misconduct. As a result, George Franz cut back Andrew's authority and ultimately terminated Andrew, effectively severing all ties with his son.

Further, in 2010 George Franz, at his own expense, retained an accountant named George "Charles" Wilkinson, Sr. ("*Wilkinson*") to review all corporate records. Mr. Wilkinson submitted his report to George Franz in 2011 (the "*Wilkinson Report*"). Exhibit 2. As the Wilkinson Report was not complete, in August 2011, after meeting with the Commission and accepting the Commission's recommendation, George Franz retained Cohen Audit Services ("*Cohen*") to perform a further audit of the Ruby accounts (the "*Cohen Audit*"). Exhibit 3.¹ Based upon the information gathered from the Wilkinson Report, the Cohen Audit, and his own internal investigation, George Franz has contacted and voluntarily paid restitution to victims of Andrew Franz, in excess of \$135,000.

¹ Though the Commission now bristles at the term "audit" and accuses George Franz of misrepresenting the scope of Cohen's work, both Cohen Audit Services and ODOC used the word in reference to Cohen's work. Moreover, Larry Roman, a Ruby client victim, accountant and academic in the field of accounting testified that "an agreed upon procedures" report as described by the Commission may be considered in his vernacular to be a "special purposes audit." Roman Depo, Exhibit 17, pp. 80-81.

It was not until March 2011 that FINRA initiated an investigation of Andrew. FINRA alleged that Andrew had obtained possession and forged signatures on four checks made payable to investors. The result of this investigation was a letter of Acceptance, Waiver and Consent (the "AWC") on May 24, 2011, whereby Andrew agreed to a permanent bar from associating with any FINRA member in any capacity. Exhibit 4.

In July 2013, Andrew pled guilty to repeatedly stealing funds from Ruby clients, including issuing false fee statements and taking trust funds. Andrew also attempted to steal funds from a former Ruby customer, which resulted in a state court criminal case against him.

Andrew is now serving a 57-month term at the Federal Correctional Institution in Ashland, Kentucky and has been ordered to pay restitution of \$357,068.77 to his victims, plus an additional \$245,352 in taxes, with penalties and interest as determined by the Internal Revenue Service. He is also subject to 300 hours of community service and three years of supervised release.

When Andrew began his prison sentence in December 2013, he left behind unpaid taxes, unpaid legal bills, at least two unanswered lawsuits, liens against his house, and other obligations.

Though heinous, Andrew's thefts from Ruby clients were actually far less than Andrew's thefts from George Franz and his own family that included: 1) hundreds of thousands of dollars from the Marie Franz Trust, the trust of his deceased mother, which was managed by George Franz for the benefit of all three of his children; 2) fees that were earned by and properly belonged to Ruby; 3) funds from his George Franz's personal

bank account; 4) funds from the accounts of his in-laws, who were Ruby customers, both while Andrew was employed at Ruby and even more so after he was terminated by his father; and 5) funds from his grandmother. Andrew also fraudulently obtained a credit card using his deceased mother's name and implicated his sister Rachel.

At various times from 2008 through 2010 representatives of the Commission and ODOC examined Ruby; not once did these agencies report Andrew's wrongful conduct or recommend that Ruby limit Andrew's authority or access to Ruby clients.

Admittedly, the scope of George Franz's resources and efforts to investigate Andrew's conduct are not nearly as broad or comprehensive as those of the Commission, FINRA, or the ODOC. Accordingly, beyond the restitution already paid, George Franz has pledged to all regulatory authorities to repay any other Ruby client victims identified by the Commission. Respondents' only condition, because of significant discrepancies between the records of the AUSA and even the Commission itself, is that there be an agreed-upon victim list. Unfortunately, the Commission has refused to meet and confer regarding the victim list and the restitution amounts.

Finally, all of George Franz's actions were voluntary, and were undertaken in advance of any action against him by the Commission. Notably, other than a lawsuit by Andrew's in-laws—in which Andrew (curiously) has not been named and from which Andrew's company, Wingate, has (more curiously) been dismissed—there have been no lawsuits or arbitrations filed by any customer against Ruby or George Franz regarding Andrew's actions. To the contrary, until the Commission's recent meetings and

statements to Ruby customers, no one closed any account due to the actions of Andrew Franz.

III. STATEMENT OF THE CASE

The Commission's action ignores many undisputed material facts and incorrectly attaches undue significance to other minor facts. In the end, the Commission fails to recognize that Respondents are not liable for Andrew's solo actions and that Respondents are, in fact, Andrew Franz's biggest victims.

Andrew was deposed by the Commission on October 4, 2011. At his deposition Andrew stated:

Look, all I can say is this. And I'm sorry for you guys that you guys are even going through this. I really am. All I can say, based upon the stupid things that I did, I've lost everything. I don't have a father. My sisters, except for the fact that I know my sister, one sister, just had a baby today. I have no interaction with them. They want no interaction with me. I'm barely hanging on to my wife by a string. I'm not blaming anybody in this matter but me, me, me, me, me.

Nobody at Ruby, nobody from my wife to my sisters had one clue that was going on. There are no outside people. There's no nothing. This was an all on me thing and me alone. And I, you know, I try not to come off as being anything other than what I am. I'm just sorry. I'm just, and I realize what I've done to my wife, my daughter and my family. I ruined for life. And there's no way I could put that back. I can't put it back.

But me coming here, for me, was a sense of I need to tell you and you what's going on, what happened. I tell you my father had no God damn clue to any of this. None. None at all.

Commission Deposition of Andrew Franz, Exhibit 5, pp. 197-198.

Andrew Franz was interviewed by the ODOC on September 8, 2011, at which time he admitted his wrongful conduct with respect to several Ruby clients. He also professed a desire to repay his father for the restitution payments that George Franz had made.

George Franz was interviewed by ODOC on September 21, 2011, at which time he confirmed the ongoing Cohen audit that he had requested, the restitution payments that he had made, and discussed his plans to compensate all client victims of Andrew Franz.

In February 2012, the Cuyahoga County Prosecutor initiated a criminal action against Andrew Franz in the Cuyahoga County Court of Common Pleas, charging Andrew with theft, aggravated theft and identity fraud involving a former Ruby client known as Eberhard Manufacturing Company.

In 2012, the Commission initiated a federal action against Andrew Franz alleging that Andrew had misappropriated \$865,969 from Ruby clients, including \$779,418 from family members and \$86,551 from other clients. *United States Securities and Exchange Commission v. Andrew J. Franz*, United States District Court, Northern District of Ohio, Case No. 5:12-CV-00642. Exhibit 6. The Commission also alleged that Andrew had misappropriated approximately \$172,000 in legitimate client fees payable to Ruby. *Id.* In March 2012, the Court entered an order enjoining Andrew from future violations, which Order was made permanent on June 14, 2012. Exhibit 7.

Administrative proceedings were initiated by the Commission on July 24, 2012 in *In the Matter of Andrew J. Franz*, Securities and Exchange Commission, File No. 3-14960. Exhibit 8. On January 18, 2013, the Commission made an initial decision permanently barring Andrew Franz from association with a broker dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent or nationally recognized statistical rating organization pursuant to Section 15(B) of the Securities

Exchange Act of 1934 and Section 203(F) of the Investment Advisers Act of 1940. Exhibit 9. This Initial Decision became final on March 15, 2013. Exhibit 10.

On July 23, 2013, Andrew waived indictment and pled guilty to federal charges, admitting that between 2006 and 2011 he had defrauded over 10 accounts out of \$366,00 -- the largest victim being the Marie Franz Trust, trust account of his deceased mother, of which George Franz was the trustee. Exhibit 11. Andrew also admitted that he filed false tax returns in 2007, 2008 and 2009, and failed to file any returns in 2010 and 2011 resulting in a tax liability of \$245,352. *Id.* According to the Plea Agreement:

Defendant ANDREW J. FRANZ ("FRANZ") knowingly devised, and intended to devise, a scheme and artifice to defraud and obtain money and property by means of materially false and fraudulently pretenses, representations, and promises through false fraudulent fee billings from the accounts of the clients of Ruby and from companies dealing with these clients' investments.

...

[Andrew] FRANZ accomplished this without the authorization of G.F. [George Franz], Ruby [Corporation] or its clients.

...

It was a further part of the scheme and artifice to defraud that Defendant [Andrew] FRANZ caused AIG SunAmerica Mutual Funds (SunAmerica) to issue checks drawn on the SunAmerica account of the Marie Franz Trust (the Trust), of which G.F. [George Franz] was the Trustee.

...

The primary source of the funds was monies from the [Marie Franz] Trust and Ruby clients' accounts that [Andrew] FRANZ had misappropriated. [Andrew] FRANZ did this to further the scheme, and to hide from G.F. [George Franz] and Ruby [Corporation] the fact that Ruby had lost clients and advisory fees.

Plea Agreement, Exhibit 11, Attachment A, Pars. 6, 11, 12 and 13.

At his sentencing on October 23, 2013, Andrew reiterated his sole responsibility for the fraud and stated:

Well, based upon what my attorney has said, I take 100 percent responsibility for what's happened here. There are no other people, there were no associations around it. It was me, me, and me.

Andrew Franz at Sentencing of Andrew Franz, *United States of America v. Andrew Franz*, United States District Court, Northern District of Ohio, Case No. 1:13CR331, October 23, 2013. Exhibit 12, p. 10.

Andrew has repeatedly lied to and concealed accurate information from the Commission, FINRA, ODOC, accountants, auditors, banks, police, creditors, prosecutors, clients, and others including – most particularly – George Franz. George Franz did not knowingly aid, abet or conspire with Andrew. Notwithstanding, George Franz has paid and attempted to pay, out of his own pocket, with no insurance available, full restitution to all of Andrew's Ruby client victims.

IV. ARGUMENT

A. RESPONDENTS ESTABLISHED REASONABLE SUPERVISORY PROCEDURES, INITIATED THE INVESTIGATION OF ANDREW FRANZ, DISCOVERED THE FRAUD, VOLUNTEERED RESTITUTION TO CUSTOMER VICTIMS, AND COOPERATED WITH ALL REGULATORY AGENCIES.

The essence of the Commission's claims is that Respondents should have discovered Andrew's wrongful conduct and should have had prescient knowledge of Andrew's lies so that they could warn Ruby clients and disclose all to the Commission in its investigation. The Commission assumes a great deal. To be blunt, if everything was so obvious why did it take the Commission more than five years to investigate and initiate this action? More importantly, what incentive was there for George Franz to conceal his

son's actions when George Franz, his family, and his company were Andrew's primary targets?

The reality is that George Franz reasonably trusted his son, and he was forthright with all regulatory agencies disclosing what he knew when he knew it. Though Respondents had procedures in place reasonably expected to prevent and detect any violation, and thus should be excepted from liability under Section 15(b)(4)(E) of the Exchange Act, Andrew Franz gamed his father's small business to avoid detection, including acting when his father was out of town, secretly diverting mail, changing documents that were initially properly issued, and lying to any inquisitors. By contrast, at all times, and at considerable inconvenience and financial expense, Ruby and George Franz have cooperated with, and not concealed anything from, clients, employees or the Commission.

To bring a claim of aiding and abetting the Commission must prove three things: 1) that another party committed a primary or independent violation; 2) that the alleged aider and abettor knew or was aware that his role was part of the overall improper activity; and 3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation. *See*, Dodd-Frank Act §§ 929M, 929N; *Investors Research Corp. v. SEC*, 628 F.2d 168, 1980 U.S. App. LEXIS 18151 (D.C. Cir. 1980); *In re. IFG Network Securities*, Administrative Proceeding, File No. 3-11179 (February 10, 2005).

Respondents do not deny the first element. However, the latter two elements of scienter and wrongful assistance on the part of Respondents are absent in this case.

To be clear, George Franz is not charged with taking money from clients or even assisting Andrew's thefts. George Franz is charged with not previously discovering and disclosing Andrew's conduct. However, that charge, even if it were true, is not the "proximate" or even a "substantial causal factor" in Andrew's fraud. *See, In re Performance Analytics, Inc., and Leslie I. Golembo*, Adv. Act Rel. No. 2036, 2002 SEC LEXIS 1552, *14 (June 17, 2002) (citing *Russo Securities Inc. and Ferdinand Russo*, Exch. Act Rel. No. 39181, 1997 SEC LEXIS 2075, *17-18 (Oct. 1, 1997) ("proximate cause") and *Rolf v. Blyth, Easton Dillon & Co., Inc.*, 570 F.2d 38, 48 (2nd Cir. 1978) ("substantial causal factor"). Andrew Franz did what he did in secret, on his own, and against the very Respondents being charged in this action. Unlike the typical supervision case, here the Respondents were the losers not the winners. Andrew concealed his actions so well that not even the SEC or the ODOC discovered them in their 2008 and 2010 investigations and branch examinations. Accordingly, absent the Commission's proof or even any allegations of scienter or of wrongful action by George Franz, Respondents cannot be charged with aiding and abetting.

Accepting the Commission's timeline, all of Andrew's wrongful conduct was committed between 2006 and 2011. During this period Andrew Franz was a registered representative associated with Allegheny Investments, Ltd. (2002-2005); Questar Capital Corporation (2005-2006); Sigma Financial Corporation (2006-2007); Fortune Financial Services, Inc. (2008-2010); and H. Beck, Inc. (2010-2011). Pursuant to the Advisers Act Sections 203(e) and 203(k) and Exchange Act Sections 15(b)(4) and 21C, a Registered Investment Adviser can only be found liable for aiding and abetting if his conduct was

knowing or reckless. George Franz hired his only son. He trained him for several years and only after Andrew was fully ready to take over the business did George Franz take extended vacations in Florida. While George Franz has repeatedly stated that he now feels morally responsible for failing to supervise his son, he did not act knowingly or recklessly with respect to Andrew and his clients.

Nevertheless, it was George Franz who voluntarily initiated a program to make restitution out of his own pocket to Andrew's victims. This program included an audit by Cohen Fund Audit Services, as suggested by the Commission. Cohen Audit Services not only failed to detect any fraud, but concluded that most Ruby clients were actually billed substantially less than their contracted rates.

It is also noted that George Franz voluntarily terminated his own son and removed Andrew's access to Ruby and its clients -- even before any regulatory finding by FINRA or any other agency.

To make sure that his customers received proper notice, after meeting with the Commission in August 2011 Respondents prepared new a draft Form ADV for filing by Ruby Corporation based upon the information that they had at the time. Exhibit 13. Respondents' counsel submitted the draft to the Commission for review in September 2011 and further offered to send the same to all Ruby clients. The Commission chose to stand down and not respond to the draft. Instead, the Commission initiated this action adding a charge that George Franz was using the ADV to miscommunicate with his customers. While Respondents deny that anything in the Form ADV was false, it would

have been preferable for the Commission to offer its comments on the form when they were requested, rather raise the issue in this action.

The violations alleged all require scienter or wrongful intent. According to the Commission, this is evidenced by the fact that Ruby remained open and profitable and that George Franz (allegedly) intentionally covered up the acts of his son and lied about them to customers and numerous regulators over a course of several years. This theory is a little far-fetched, and there is a much more obvious, and innocent explanation: George Franz didn't tell people because George Franz did not know, and could not have known, about Andrew's thefts until he began to have suspicions in 2010 and he received a preliminary report from Charles Wilkinson in 2011.

Former employee Annmarie Stansfield testified in a deposition before ODOC on May 22, 2012. Stansfield Depo, Exhibit 14. She stated that she had worked at Ruby from 2007 through November 2010. *Id.*, p. 12. She stated that George was a "hands on" employer who called often. *Id.*, p. 22. When asked when she first saw any issues, the witness testified, somewhat ambiguously about September 2010 (pp. 26-27), May 2008 (p. 27), summer 2008 (p. 27), and fall 2009 (p. 28). *Id.* She testified that she never thought George Franz was dishonest. *Id.*, pp. 32-33. She also testified that Sharon Vogelsberger, another employee of Ruby, had never observed any dishonesty or wrongdoing. *Id.*, p. 34.

Further, as former Ruby employee Cate Mares testified in her deposition, the first time she discovered "abnormalities" in Andrew's conduct was February/March 2010 when she discovered uncashed checks made payable to Ruby in Andrew's desk. Mares Depo,

Exhibit 15, p. 22-24. She immediately reported this to George Franz. *Id.*, p. 24. Notably, these were not thefts from client accounts, but, rather, legitimate fees charged by Ruby.

Finally, Ruby accountant Charles Wilkinson stated that he first recognized that Andrew had been misappropriating funds from client accounts in 2010. Wilkinson Depo, Exhibit 16, p. 58.

In sum, despite years preparing and training Andrew in the business, George Franz admits that on a personal level he feels responsible for the acts of his son. However, George Franz denies that he ever knowingly misled a client or the Commission, and he asks that his acceptance of moral responsibility not be misconstrued as aiding and abetting Andrew as a matter of law.

B. THE COMMISSION'S CLAIMS ARE BARRED BY THE STATUTE OF LIMITATIONS.

All claims under the Investment Advisers Act of 1940 against Respondents are barred by the applicable statute of limitations. U.S. Code, 28 U.S.C. §2462 requires an action for civil penalties to be brought within five years "from the date when the claim first accrued." As Andrew's wrongful conduct began in 2006 and no action was timely initiated against George Franz by 2011, all claims for penalties against George Franz are time barred pursuant to *Gabelli v. Securities and Exchange Commission*, 2013 WL 691002 (U.S. Feb. 27, 2013). *See also, Securities Exchange Commission v. Pentagon Capital Management*, 725 F.3d 279 (2nd Cir. 2013). As the Supreme Court noted, the statute of limitations begins to run "when the claim first accrued," i.e. when the violation takes place, not when it was or should have been discovered. As the Court determined, since it is the government's job to work diligently to uncover fraudulent behavior, the

statute is not extended for the imposition of civil penalties such as those sought by the Commission in this action. Accordingly, the claims in this case are time barred.

C. THE COMMISSION WAS NOT OBJECTIVE IN ITS PROSECUTION OF THIS ACTION.

The depositions in this matter are revealing in that the discussions during the depositions detail the predisposition of the Commission. While all areas are fair game in the course of an investigation, it is not appropriate to taint a witness under the guise of “educating” him or her about their investment counselor. The comments of the Commission fairly bring into question the necessity for objectivity that was missing in this investigation.

In the deposition of Ruby victim Larry Roman, the witness testified that George Franz had previously advised the witness of the Commission’s investigation and had specifically instructed the witness to tell the truth at his deposition. Roman Depo, Exhibit 17, pp. 19-21. Doing his best, Mr. Roman testified that he either did not recall or was very confused about several items stating: “I think I may have glanced at that, I may have saw the numbers, but I may not have-” (p. 138), “I’m not sure” (p. 138), “I would have hoped I would have read it carefully, but clearly I didn’t” (p. 139), “I honestly don’t recall” (p. 141), “It just doesn’t ring a bell, but I’m not saying it didn’t happen” (p. 141), “I don’t recall, I don’t recall that. Just for some reason it doesn’t – I just don’t recall that” (p. 142), “I’m not sure, I probably, looking back, in hindsight, I’m not sure what ewe received or didn’t. I’m getting very, very confused right now” (p. 145), “it’s possible” (p. 146), “I don’t recall” (p. 147), “It just doesn’t” (p. 149), “I’m fallible” (p. 150), “my mind is spinning right about now” (p. 150), “I’m just speculating” (p. 157), “be kind” (p. 157), “I just don’t

remember," "could be," and "We probably signed it, didn't we? Probably? Or I don't know." (p. 174). Apparently feeling that these answers were not adequate for its purposes, the Commission instead offered its own opinions such as:

It's unfortunate, but, you know, Andy did what he did, he's a thief, but when his dad found out that he was a thief, he had an obligation to kick him to the curb and tell people.

Id., p. 210.

This theme continued in the deposition of Ruby victim Dale Morris. Dale Morris Depo, Exhibit 18. Specifically, the witness testified that he trusted George Franz, "I really do trust George. I trust him today. I trusted him then....I do have trust in George and everything he does and says. I believe him today, I do." *Id.*, p. 74. Yet, the Commission made repeated efforts to turn the witness including:

And I'm not saying that he needs to turn his son into the police the first time he sees something going on, but firing him would be good...So that he's not around to take from you people, you clients. So, anyway, that is kind of what we're looking at and I'm not trying to cause trouble here. I'm not trying to poison you against anybody, I'm just telling you the facts as we've discovered them.

Id., p. 95.

Likewise in the deposition of Ruby victim Lora Morris the witness testified that she trusted George Franz, but not Andrew Franz. Lora Morris Depo, Exhibit 19, p. 57.

Notwithstanding, the Commission attempted to taint the testimony by saying:

I'm not trying just to stir up trouble. I'm not trying to poison anybody against anybody. But, I feel you have the right to know some of these facts and, obviously, I had to tell you some of this in order to ask whether any of this had been told to you.

Id., p. 90.

The Commission also offered its own legal conclusions such as:

that doesn't change the fact that George lied to you and failed to tell you things that you needed to know and violating your trust and all that...

Id., p. 95.

In the deposition of Ruby victim Mark Jaynes, the Commission repeatedly claimed that George Franz had misled Mr. Jaynes about his account. *See generally*, Jaynes Deposition, Exhibit 20. The Commission then lightened up on the accusations by saying:

So, obviously this is all. I mean, I don't like being the bearer of bad news, but I wanted you to know. I feel that you have a right to know what is going on in your account.

Id., p. 55.

When the witness countered that in fact George Franz might not have misled him and may have given him all of the previously referenced information stating, "[h]e might have told me that, I don't know" (*Id.*, p. 58) and "I guess in a roundabout way, he did and maybe I just didn't understand it" (*Id.*, p. 61), the Commission pressed and accused George Franz of lying to his client:

In a roundabout way of talking, he's talking about this. But he's not because if he wanted to tell the truth, he would tell you, Andy stole from you and I'm repaying the money.

...

So, frankly, he's relying on you not noticing either way and hoping that you never find out the truth.

...

We believe that George was aware that Andy was taking money from clients back in 2010. That he could have stopped it, could have fired Andy. At the very least he could have told people, I mean, look at the first quarter here, 2010. He could have told you Andy's stealing money and you could have at least had an opportunity to protect yourself or look at things a little more closely.

Id., pp. 62-64.

When the witness rebuffed the Commission and said that Andrew was George Franz's own flesh and blood "it's not like somebody he hired off the street" (*Id.*, p. 64) the Commission acted more aggressive:

Okay, I'll put my cards on the table here. We've looked at a lot of activity of what Andy was doing and what George knew...and as early as January 2007, George knew that Andy had taken legitimate fee checks (actually from Ruby, not clients)...in 2009, George learned that Andy had stolen a few thousand dollars from a family trust (not a Ruby client)...and that continued all throughout 2010 and into earlier 2011, until he was finally fired in 2011...and obviously we believe that George should have taken action earlier than that to protect the clients.

Id., p. 65.

Then to make sure it had turned the witness, the Commission rhetorically asked: "I mean, just being honest, does this give you a new insight as to whether you should trust George so much?" *Id.*, p. 66. Yet, despite this badgering, when asked again about his understanding, the witness demurred and said, "that's probably partially my fault because I, I don't know" (*Id.*, p. 70). Further, when asked whether George Franz may have acted on purpose and whether Mr. Jaynes doubted George's truthfulness, Mr. Jaynes declined and said, "I don't know, yeah...to be fair to George too, I mean - you know, of course I need to be fair to myself, but to be fair to George, he was, you know, really distraught and him driving all the way down here from the Cleveland area and having to tell me that looked to me like one of the hardest things he had to do... I have to think about it. I don't know." *Id.*, pp. 70, 72 and 73. At conclusion Mr. Jaynes was so

confused by the Commission that when he was asked if he wanted to change any answers he admitted, “[a]t this point, I don’t even remember what I said.” *Id.*, p. 76.

The Commission also tainted the deposition testimony of Ruby client victim Catherine Mineo. Mineo Depo, Exhibit 21. This was a witness who had been on pain killers at the relevant time and stated, “[y]ou have to realize at that time, when I took the fall from the bike, and I was in a lot of pain and going for MRIs and doing Vicodin everyday...I was more concerned with I needed to get relief from my ongoing pain.” *Id.*, p. 118. She also had a weak memory and kept poor records, admitting, “I’m not a very good keeper of documentation...I’m just not a good paper person keeper.” *Id.*, p. 58. This did not stop the Commission from assailing George Franz:

If Andy had been fired in 2009 or earlier, he wouldn’t have been around to do this.

...

George wanted to pretend that he told you all of these things and that he sent you this letter.

...

And that’s why I wanted to show you these documents. I don’t want you to take my word for it. I want to prove it to you, and that’s what I am doing here.

...

We believe that George knew a lot of this stuff way before this and so he should have kicked him [Andrew Franz] out of there, otherwise Andy would not have been around to take your money.

...

He [George Franz] could have nipped it in the bud early on.

...

But what he [George Franz] is trying to do is rewrite history that he told you the truth back then, back in 2012...[w]hich he didn’t.

Id., pp. 43, 96, 99 and 149.

The Commission also misled Ms. Mineo as to the confidentiality of her deposition, ultimately misstating, "I ask that you maintain the confidentiality of our conversation today and not discuss the contents with anybody but an attorney." *Id.*, p. 150.

The testimony of John Krajnik is significant. Krajnik Depo, Exhibit 22. Mr. Krajnik has been a Series 7 registered representative since 2007 and has a spotless regulatory record. More importantly, he is expected to take over Ruby's accounts when George Franz steps down. As Mr. Krajnik testified at his deposition on August 9, 2013, George Franz had disclosed Andrew's conduct and the Commission's investigations in 2011. *Id.*, pp. 26-33 and 36-40. George Franz also told him how he planned to make Andrew Franz's victims whole. *Id.*, p. 32. Mr. Krajnik further testified his belief that it was George Franz's former employee, Cate Mares, whose husband was a computer expert, and who feared George Franz's effort to sell the Ruby business to John Krajnik and Ed Wilson in December 2011, who had deleted files from Ruby's computers – not George Franz.² *Id.*, pp. 55-57, 59-60, 65-79 and 83. As he stated, "I know that no one else in the office [besides Cate Mares] had the skills to do that...And frankly George is the most inept person in operating a computer I've probably ever seen. He can't even create a Word document." *Id.*, p. 79. Also, "And the whole point is that George wanted the files,

² It was at the same time as this transaction that Ruby records were shredded. Though the Commission accuses George Franz of nefarious purposes, George Franz has testified that he simply asked Wilson and Krajnik what records they needed to take over the business and superfluous documents were apparently trashed. Moreover, George Franz denies that he himself destroyed any documents and no witness deposed by the Commission or ODOC has testified that George Franz had any involvement in the process.

and Nora wanted the files. Deleting them, it's illogical to assume that they deleted them. The way Cate's action was, it's logical that she was the only one who deleted them." *Id.*, p. 83. Though the 2011 proposed joint sale to Krajnik and Wilson fell through, Mr. Krajnik has reached a settlement agreement with George Franz over the failed transaction. Most recently, abandoning John Wilson, Mr. Krajnik has further agreed to enter into a new referral agreement with George Franz once George Franz leaves the business as anticipated in early 2014.

Inexplicably, the Commission has relied heavily upon the testimony of George "Charles" Wilkinson, Sr. Mr. Wilkinson is a former broker associated with WRP Investments, Inc. in Ohio. Though Mr. Wilkinson has stated that George Franz did not take any money from client accounts (pp. 35-36) his overall testimony is equivocal at best. Mr. Wilkinson is a former friend of George Franz and he served as Ruby's accountant until George Franz fired him in 2011, in part because the Wilkinson Report that he prepared at Respondent's request was incomplete. Curiously, the Commission uses this 2011 Wilkinson Report, solicited by George Franz in 2010, to imply that George Franz should have known of Andrew Franz's misconduct back in 2006. The Commission neglects to note that the alleged theft by Andrew Franz in 2006 was of Ruby funds and did not involve any client accounts. Moreover, as the records of the Commission now make clear, and as Mr. Wilkinson has himself testified in deposition (pp. 52-54) the report was incomplete, and all findings were not even discussed with George Franz (pp. 74-75) -- thus challenging the Commission's conclusion that George Franz should have relied upon the report to turn in his son. Notable as well, Mr. Wilkinson has a

questionable reputation as he himself entered into an AWC with the National Association of Securities Dealers ("NASD") in 2002 and agreed to a three-month suspension for selling hundreds of thousands of dollars of promissory notes in violation of Ohio Revised Code Section 1707.44(C) and Ohio Administrative Code 1301:6-3-19(A)(1).

D. **THE APPROPRIATE SANCTIONS ARE DE MINIMUS.**

Penalties are designed, in part, to punish the individual violators of securities laws. *SEC v. Moran*, 944 F. Supp. 286, 296 (S.D.N.Y. 1996). Courts look to a variety of factors under Advisers Act Section 203(f), including, but not limited to: 1) the egregiousness of the defendant's conduct; 2) the degree of the defendant's scienter; 3) whether the defendant's conduct created substantial losses or the risk of substantial losses to other persons; 4) whether the defendant's conduct was isolated or recurrent; and 5) whether the penalty should be reduced due to the defendant's financial condition. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd* on other grounds, 450 U.S. 91 (1981) and *SEC v. Coates*, 137 F. Supp.2d 413, 428-29 (S.D.N.Y. 2001). These factors applied to the present case indicate that, if anything, George Franz should pay no more than a *de minimus* penalty.

First and foremost, the record is clear that the wrongful conduct was solely attributable to Andrew Franz. George Franz's violation, if any, was a failure to supervise. Typically, the Commission does not impose steep civil penalties against individuals for this sole violation. In *In re TJM Proprietary Trading, LLC*, Exchange Act Rel. No. 60440 (Aug. 5, 2009), the Commission declined to impose civil penalties for a single violation of a failure to supervise. In TJM, John Burke served as the Chief Operating Officer of TJM

Proprietary Trading, LLC, a Chicago-based company that was a registered market-maker with the Chicago Board Operations Exchange, Inc. and a registered broker-dealer with the Commission. Burke was responsible for supervising Michael Benson, a trader at TJM. *Id.* at *3. Burke failed to supervise Benson, who engaged in multiple violations of Rules 203(b)(1) and (b)(3) of Regulation SHO, despite warnings from other TJM employees. *Id.* at *6. Though despite findings that TJM received ill-gotten gains of \$541,000 and Burke had failed to reasonably supervise Benson, the Commission imposed no civil penalty and suspended Burke from acting as a supervisor for nine months. *Id.* at *9.

Second, a defendant's level of cooperation and level of contrition should be considered when determining the imposition of civil penalties. *See e.g., Druffner*, No. 03-12154-NMG, 2011 U.S. Dist. LEXIS 73031, at * 12 (noting that courts may consider such factors in determining civil penalties). *See, In re Littell, Investment Act Rel. No. 2203*, 2003 SEC LEXIS 2958 (Dec. 15, 2003) (Commission held that founder and Senior Managing Director of Marque Millennium Group, Ltd. did not need to pay a civil penalty for his failure to supervise because of his complete cooperation with the Commission and his personal restitution to the victims.) In this case, George Franz has fully admitted his supervisory responsibility in this matter and cooperated with the Commission and all regulatory investigators. Moreover, George Franz has personally paid restitution to all of Andrew's Ruby victims that he discovered, and has pledged to pay restitution to any unknown Ruby victims who may be discovered in the future.

Third, George Franz should be spared a larger civil penalty because he has already suffered enough personal and economic hardship. In *In re Horning, Initial Decision Rel. No. 318*, 2006 SEC LEXIS 2082 (Sept. 19, 2006), the Commission declined to impose civil penalties against Stephen Horning who failed to supervise the conduct of Judy Clarke, the head trader at Rocky Mountain and Horning's best friend, and Leslie Andrade, the head of Rocky Mountain's Operations Department. *Id.* at *5-6. Though it found that Horning was responsible for a failure to supervise and that he had willfully caused violations of Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act, the Commission ordered only a suspension from brokering, a complete bar from working in a supervisory capacity -- and no civil penalty. *Id.* at *75-76, 78.

Fourth, because Andrew Franz is barred from the industry and George Franz no longer supervises him or any broker's activities, there is no basis for injunctive relief against George Franz in his supervisory capacity. As the Commission itself has noted, "injunctive and administrative remedies have different purposes, one to restrain further violative activity, and the other to determine whether it would be in the public interest to restrict a respondent's activities in the Securities Industry." *In re Radano Investment Advisers Act Rel No. 2750*, (June 30, 2008) citing *A.J. White & Co.*, 45 S.E.C 459, 463 (1974).

Several recent cases also evidence minimal penalties in failure to supervise cases, even in matters of far greater magnitude: *In re. 1st Discount Brokerage and Michael Fisher*, Administrative Proceeding, File No. 3-14710 (January 23, 2012) (after broker fraud of \$9,000,000 that spanned seven years, broker dealer sanctioned \$40,000 and

supervisor sanctioned \$10,000 and nine month supervisory suspension); *In re. Jack C. Smith, Jr.*, Administrative Proceeding, File No. 3-14229 (February 3, 2011) (despite being the supervisor during of a \$17,000,000 fraud, sanction is a nine month suspension from supervision and a \$25,000 civil penalty); *In re Beth R. Chapman*, Administrative Proceeding, File No. 3-13868, 2010 SEC Lexis 1355 (April 23, 2010) (supervisor of broker who took more than \$330,00 from an 83-year old customer received barred from industry and ordered to pay \$25,000 penalty); and *In re Elizabeth Pagliarini*, Administrative Proceeding, File No. 3-14273 (February 24, 2011) (chief compliance officer during \$65,500,000 manipulation suspended from supervisory activity for twelve months and ordered to pay civil penalty of \$20,000).

The penalty for any failure to supervise in this situation where the Respondents themselves were victims is *de minimus*. The financial and injunctive relief sought by the Commission is not warranted.

CONCLUSION

Having failed to recover any funds from Andrew Franz, this action is a search for deep pockets. George B. Franz, III and Ruby Corporation did not aid or abet Andrew Franz's wrongful conduct and have fully cooperated with all regulators. In the process, George Franz has made reasonable efforts to review the books and records of Ruby Corporation, he has strived to meet all of his compliance obligations, he has compensated and offered to compensate all of Andrew Franz's victims (known and unknown), and he has suffered severe personal and financial hardship as Andrew Franz's primary victim.

Accordingly, Respondents' offer of restitution should be accepted and all other claims should be dismissed.

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Respectfully submitted,

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