

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 9454 / September 23, 2013**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 70473 / September 23, 2013**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3674 / September 23, 2013**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 30694 / September 23, 2013**

**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.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT  
TO SECTION 8A OF THE SECURITIES  
ACT OF 1933, SECTIONS 15(b) AND  
21C OF THE SECURITIES  
EXCHANGE ACT OF 1934, SECTION  
203(f) OF THE INVESTMENT  
ADVISERS ACT OF 1940, AND  
SECTION 9(b) OF THE INVESTMENT  
COMPANY ACT OF 1940 AND  
NOTICE OF HEARING**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“Company Act”) against 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”).

## II.

After an investigation, the Division of Enforcement alleges that:

### A. RESPONDENTS

1. **Donald J. Anthony, Jr.**, 60 years old, is a resident of Loudonville, NY. He was registered with McGinn, Smith & Co., Inc. (“MS & Co.”) from November 1997 to December 2009, and McGinn, Smith Advisors, LLC (“MS Advisors”) from February 2006 to December 2009.
2. **Frank H. Chiappone**, 57 years old, is a resident of Clifton Park, NY. He was registered with MS & Co. from February 1989 to December 2009.
3. **Richard D. Feldmann**, 74 years old, is a resident of Delmar, NY. He was registered with MS & Co. from July 1987 to December 2009.
4. **William P. Gamello**, 49 years old, is a resident of Rexford, NY. He was registered with MS & Co. from April 2005 to December 2009.
5. **Andrew G. Guzzetti**, 66 years old, is a resident of Saratoga Springs, NY. He was registered with MS & Co. from September 2004 to December 2009.
6. **William F. Lex**, 67 years old, is a resident of Phoenixville, PA. He was registered with MS & Co. from January 1983 to December 2009.
7. **Thomas E. Livingston**, 55 years old, is a resident of Slingerlands, NY. He was registered with MS & Co. from October 1988 to December 2009, and became a 20% shareholder of MS Holdings in 2004.
8. **Brian T. Mayer**, 40 years old, is a resident of Princeton, NJ. Mayer was registered with MS & Co. from July 2001 to December 2009, and MS Advisors from February 2006 to April 2009.
9. **Philip S. Rabinovich**, 39 years old, is a resident of Roslyn, NY. He was registered with MS & Co. from July 2001 to December 2009, and with MS Advisors from August 2006 to December 2009.
10. **Ryan C. Rogers**, 40 years old, is a resident of East Northport, NY. He was registered with MS & Co. from July 2001 to December 2009, and with MS Advisors from February 2006 to April 2009.

## **B. RELEVANT ENTITIES<sup>1</sup> AND INDIVIDUALS**

11. **MS & Co.**, a New York corporation founded in 1980 by David Smith and Timothy McGinn, had its principal place of business at 99 Pine Street, Albany, NY, and maintained branch offices at Clifton Park, NY, New York, NY, and King of Prussia, PA. MS & Co. was registered with the Commission as a broker-dealer beginning in 1980 and as an investment adviser in April 2009. It was owned by Smith (50%), McGinn (50%; 30% after 2004), and Thomas Livingston (20% after 2004). From 2003 to 2009, MS & Co. had about 55 employees, including about 35 registered representatives. On December 24, 2009, MS & Co. filed a partial BD-W. On March 9, 2010, MS & Co. also withdrew its investment adviser registration. FINRA terminated MS & Co.'s FINRA membership on August 4, 2010.

12. **MS Advisors** was a New York corporation formed in 2003 with its principal place of business at 99 Pine Street, Albany, New York. MS Advisors was owned by Smith (50%), McGinn (30%) and Livingston (20%). MS Advisors was registered as an investment adviser with the Commission from January 3, 2006 to April 24, 2009, and was the investment adviser to the Four Funds (defined below) until April 2009, when it was replaced by MS & Co.

13. **McGinn, Smith Holdings, LLC (“MS Holdings”)** was owned by Smith (50%), McGinn (30%) and Livingston (20%).

14. **McGinn, Smith Capital Holdings Corp. (“MS Capital”)** was a New York corporation formed in 1989 with its principal place of business at 99 Pine Street, Albany, New York. MS Capital was owned by MS Holdings (52%), McGinn (24%) and Smith (24%). MS Capital was the indenture trustee, the servicing agent and the collateral agent for the Four Funds, and the trustee for all the Trusts created between 2006 and 2009. Smith was president and McGinn was chairman of the board.

15. The **Four Funds** were New York limited liability companies, whose sole managing member was MS Advisors. MS & Co. served as the placement agent for the Four Funds offerings, and MS Capital acted as the Trustee. The Four Funds shared offices with MS & Co. and the other McGinn Smith entities at 99 Pine Street, Albany, NY. The Four Funds offerings are listed below, along with the promised rate of return, the maximum amount of the offering, and the date of the PPM:

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<sup>1</sup> On April 20, 2010, the United States District Court for the Northern District of New York granted the SEC's motion for a temporary restraining order and appointed a Receiver over numerous entities controlled or owned by Timothy McGinn and David Smith. *See SEC v. McGinn Smith & Co., Inc., et al.*, 10-CV-457 (N.D.N.Y.) (GLS/CFH) (Dkt. Nos. 4, 5, 96). All the McGinn Smith entities—including MS & Co., MS Advisors, MS Capital, MS Holdings, FIIN, FEIN, FAIN and TAIN—remain under the Receiver's control.

- (a) First Independent Income Notes, LLC (“FIIN”), 5%/7.5%/10.25% (\$20 million) (9/15/03);
- (b) First Excelsior Income Notes LLC (“FEIN”), 5%/7.5%/10.25% (\$20 million) (1/16/04);
- (c) Third Albany Income Notes, LLC (“TAIN”), 5.75%/7.75%/10.25% (\$30 million) (11/1/04); and
- (d) First Advisory Income Notes, LLC (“FAIN”), 6%/7.75%/10.25% (\$20 million) (10/1/05).

16. The **Trust Offerings** were offerings by special purpose entities, purportedly to invest in contracts for burglar alarm service, “triple play” (broadband, cable and telephone) service or luxury cruises. MS & Co. acted as a placement agent and MS Capital acted as Trustee for the Trust Offerings. The Trust Offerings are listed below, along with the promised rate of return, the maximum amount of the offering, and the date of the PPM:

- (a) TDM Cable Trust 06, 7.75%/9.25% (\$3,550,000) (11/13/06)
- (b) TDM Verifier Trust 07, 8.25%/9% (\$3,475,000) (2/23/07)
- (c) Firstline Senior Trust 07, 9.25% (\$1,850,000) (5/19/07)
- (d) Firstline Trust 07, 11% (\$1,867,000) (5/19/07)
- (e) Firstline Senior Trust 07 Series B, 9.5% (\$1,435,000) (10/19/07)
- (f) TDM Luxury Cruise Trust 07, 10% (\$3,630,000) (7/16/07)
- (g) Firstline Trust 07 Series B, 11% (\$2,115,000) (10/19/07)
- (h) TDM Verifier Trust 08, 8.50%/10% (\$3,850,000) (12/17/07)
- (i) Cruise Charter Ventures Trust 08, 13% (\$3,250,000) (2/14/08)
- (j) Integrated Excellence Sr. Trust 08, 9% (\$900,000) (5/30/08)
- (k) Integrated Excellence Jr. Trust 08, 10% (\$580,000) (5/30/08)
- (l) Fortress Trust 08, 13% (\$3,060,000) (9/24/08)
- (m) TDM Cable Trust 06, 10% (\$1,380,000) (11/17/08)
- (n) TDM Verifier Trust 09, 10% (\$1,300,000) (12/15/08)
- (o) TDMM Cable Jr Trust 09, 11% (\$1,325,000) (1/19/09)
- (p) TDMM Cable Sr. Trust 09, 9% (\$1,550,000) (1/19/09)
- (q) TDM Verifier Trust 07R, 9% (\$2,100,000) (2/2/09)
- (r) TDM Verifier Trust 08R, 9% (\$2,005,000) (7/6/09)
- (s) TDMM Benchmark Trust 09, 8%, 9%, 10%, 11%, 12% (\$3,000,000) (8/20/09)
- (t) TDM Verifier Trust 11, 9% (\$1,550,000) (9/3/09)
- (u) Cruise Charter Ventures, LLC, 12% (\$400,000) (9/25/09)

17. **McGinn Smith Transaction Funding (“MSTF”)** was a New York corporation formed in 2008. Like the Four Funds and Trust offerings, the \$10 million MSTF offering on April 22, 2008 was underwritten by MS & Co.

18. **Timothy M. McGinn**, 64 years old, was the chairman, secretary and co-owner of MS & Co. From July 2003 through May 2006, McGinn served as CEO of Integrated Alarm Services Group, Inc. (“IASG”), which went public in July 2003. In September 2011, FINRA permanently barred McGinn from associating with any FINRA member. On February 6, 2013, following a four-week trial, a jury in the Northern District of New York found McGinn guilty of multiple counts of mail and wire fraud, securities fraud, and filing false tax returns. *United States v. Timothy M. McGinn & David L. Smith*,

12-CR-28 (DNH) (N.D.N.Y.). On August 7, 2013, McGinn was sentenced to 15 years in prison and ordered to pay restitution of \$5,992,800.

19. **David L. Smith**, 67 years old, was the president and chief executive officer of MS & Co. and the manager of the Four Funds. Until 2007, Smith was also the chief compliance officer of MS & Co. In September 2011, FINRA permanently barred Smith from associating with any FINRA member. On February 6, 2013, following a four-week trial, a jury in the Northern District of New York found Smith guilty of multiple counts of mail and wire fraud, securities fraud, and filing false tax returns. *United States v. Timothy M. McGinn & David L. Smith*, 12-CR-28 (DNH) (N.D.N.Y.). On August 7, 2013, Smith was sentenced to 10 years in prison and ordered to pay restitution of \$5,989,736.

### **C. OVERVIEW**

20. Respondents Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers were among the top-selling brokers at MS & Co. They sold millions of dollars of MS & Co. private placements in spite of numerous red flags, including a policy—which was clearly inconsistent with the terms of the offerings—that required them to “replace” customers seeking to redeem notes with new customers before the redemption would be honored. Guzzetti, a supervisor at MS & Co., failed to take any action despite knowledge of red flags. Based on their conduct, Respondents committed the following violations:

- a) Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers willfully violated Sections 5(a) and (c) of the Securities Act by offering and selling notes for which no registration statements were in effect;
- b) Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by knowingly or recklessly, or negligently, failing to perform reasonable due diligence to form a reasonable basis for their recommendations to customers, and made misrepresentations and omissions in recommending the Four Funds and Trust Offerings; and
- c) Guzzetti failed reasonably to supervise the other Respondents, pursuant to Section 15(b)(6), incorporating by reference Section 15(b)(4)(E) of the Exchange Act.

### **D. THE MS & CO. OFFERINGS**

21. David Smith and Timothy McGinn created and controlled the Four Funds and Trust Offerings. The offerings raised more than \$125 million from more than 750 investors. Investor losses exceed \$80 million.

22. The Four Funds offerings—FIIN (Sept. 2003), FEIN (Jan. 2004), TAIN (Nov. 2004) and FAIN (Oct. 2005)—raised at least \$85 million. Smith controlled the

issuers, prepared the private placement memoranda (“PPMs”), set the terms of the offerings, controlled the investor money, and made all the investment decisions. Four Funds investors were promised quarterly interest payments and a return of principal upon maturity. Each offering had three tranches: the five-year “secured junior” notes paid 10.25%; the three or five year “secured senior subordinated” paid 7.5% or 7.75%; and the one-year “secured senior” notes paid 5%, 5.75% or 6%.

23. Although the Four Funds PPMs labeled each tranche as “secured,” there were no secured assets subject to forfeiture in the event that a particular Fund failed.

24. According to the PPMs, MS & Co., as the placement agent, was to receive a commission of 2% of the offering proceeds. In addition, according to the PPMs, the brokers were entitled to (and did receive) “incentive commissions . . . [paid] to our managing member’s salesmen at the rate of 2% of the aggregate principal amount of the notes per year over the term of the notes.”

25. Smith had no experience in making investment decisions and managing investments for entities like the Four Funds, and Smith had broad flexibility in making investment decisions. As the PPMs for the offerings stated, each of the Four Funds was:

formed to identify and acquire various public and/or private investments, which may include, without limitation, debt securities, collateralized debt obligations, bonds, equity securities, trust preferred, collateralized stock, convertible stock, bridge loans, leases, mortgages, equipment leases, securitized cash flow instruments, and any other investments that may add value to our portfolio . . . .

26. The PPMs stated that the notes would be offered only to accredited investors, as defined in Rule 501(a) of Regulation D. To this end, the PPMs required that each investor “represent in writing that it qualifies as an ‘accredited investor’ . . . and must demonstrate the basis for such qualification.” The subscription agreements similarly reiterated that the notes were offered to accredited investors only.

27. Despite these representations, each of the Four Funds offerings had more than 35 unaccredited investors. The Respondents sold the Four Funds to unaccredited investors.

28. In September 2003, just weeks after the launch of the FIIN offering, Smith began diverting millions of dollars to pay investors in pre-2003 MS & Co. offerings.<sup>2</sup>

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<sup>2</sup> From 1990 through early 2003, Smith and McGinn orchestrated, through MS & Co. and related entities, dozens of note offerings secured by residential alarm contracts.

Overall, Smith used at least \$12.8 million of the Four Funds offering proceeds to pay investors in pre-2003 MS & Co. offerings.

29. Smith invested a majority of the Four Funds' proceeds in entities that were affiliated with MS & Co., even though the PPM did not disclose this, and in risky and highly speculative venture capital investments. For example, Smith invested \$8.8 million in alseT Management, a start-up partially-owned and controlled by Livingston and Smith himself, which never earned any revenue. The Four Funds' investments did not generate sufficient returns required to meet the issuers' obligations to investors.

30. In 2006, McGinn returned to MS & Co. on a full-time basis after nearly three years as CEO of IASG. McGinn created the twenty-one Trust Offerings, plus MSTF, that raised over \$41 million. The Trust Offerings ostensibly were created to fund entities engaged in specific areas, such as burglar alarm service, triple play service, or luxury cruises. These entities, however, were not funded directly by the issuer; instead, in most cases, the offering proceeds were first transferred to various conduit entities, primarily McGinn Smith Funding LLC (the "MSF Conduit") or TDM Cable Funding LLC (the "TDM Conduit").

31. The proceeds of the Trust Offerings were commingled and then used as needed by MS & Co., including infusing cash into the faltering Four Funds. The conduits and their corresponding Trust Offerings are listed below:

TDM Conduit

- TDM Cable Trust 06, 7.75%/9.25% (11/13/2006)
- TDM Verifier Trust 07, 8.25%/9.00% (2/23/2007)
- TDM Luxury Cruise, 10% (7/16/2007)
- TDM Cable Trust 06, 10% (11/17/2008)
- TDMM Cable Senior Trust 09, 9% (1/19/2009)
- TDMM Cable Jr. Trust 09, 11% (1/19/2009)
- TDM Verifier Trust 07R, 9% (2/2/2009)
- TDM Verifier Trust 08R (7/6/2009)

MSF Conduit

- Firstline Senior Trust 07, 9.25%/11% (5/19/2007)
- Firstline Trust 07 Series B, 9.5%/11% (10/19/2007)
- TDM Verifier Trust 08, 8.5%/10% (12/17/2007)
- TDM Verifier Trust 09, 10% (12/15/2008)

32. The Trust PPMs stated that they would "generally be offered only to accredited investors," but also provided for 35 or fewer unaccredited investors, supposedly under Rule 506. None of the Trust Offerings exceeded 35 unaccredited investors. When integrated according to their Conduit entity, however, Rule 506's limitation on unaccredited investors was breached: at least 69 investors in the Trusts tied to the TDM Conduit were unaccredited, and at least 59 investors in the Trusts linked to the MSF Conduit were unaccredited.

33. The Trust Offerings continued the egregious misuse of investor funds. Smith and McGinn, for example, took for personal use millions of dollars in offering proceeds from the TDM Cable 06, TDMM Cable, Integrated Excellence, MSTF and Fortress offerings, used investor funds to pay earlier noteholders, and used the Trust Offering proceeds to satisfy liquidity needs for other MS & Co. entities.

#### **E. THE RESPONDENTS' ILLEGAL CONDUCT**

34. The Respondents, as associated persons of a broker-dealer, had an obligation to conduct a reasonable investigation of the issuers in order to form a reasonable basis for any recommendation to customers regarding the MS & Co. offerings. By making a recommendation, the Respondents implicitly represented to their customers that they had an adequate basis for the recommendation. A broker has a duty to investigate the truth of the representations he makes to customers, because, by virtue of his title, customers are entitled to presume that the representations made were the result of reasonable investigation.

35. The Respondents blindly relied upon Smith and McGinn, even in the face of red flags. The Respondents, as licensed securities professionals, knew or should have known that securities issued by smaller companies of recent origin require more thorough investigation. They should not simply parrot the marketing information furnished by Smith and McGinn, particularly in the face of red flags. In addition, where Respondents lacked essential information about an issuer or its securities when making a recommendation, they failed to disclose this fact as well as the risks that arose from their lack of information.

36. The Respondents' due diligence, which at best consisted of reading the PPMs, was wholly inadequate, despite their knowledge that the issuers were completely controlled by Smith and McGinn. There were numerous red flags, moreover, that should have alerted the Respondents to the need for a thorough investigation. Instead, the Respondents blindly sold whatever private placement Smith and McGinn told them to sell.

37. The Respondents also made material misrepresentations and omissions when recommending the Four Funds and Trust Offerings to their customers.

#### **The Respondents Knew of Red Flags Surrounding the Four Funds Offerings.**

38. Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers performed inadequate due diligence prior to recommending the Four Funds to their customers. The PPMs for the Four Funds, which they read or were reckless in not reading, made disclosures that should have caused the Respondents, as associated persons of a broker-dealer, to conduct a searching inquiry prior to recommending the products to their customers. This heightened duty arose from the following factors:

- a. The PPMs made clear that Smith owned and controlled each of the issuers—which were new, single-purpose entities with no operating history—as well as the placement agent (MS & Co.) and the trustee. Smith also had

total control over the disposition of investor funds, with absolutely no oversight or control. As a result, the Respondents should have made specific inquiries as to how customer money would be invested before recommending the Four Funds to their customers.

- b. The Respondents knew or should have known that Smith had never before managed offerings of the size and scope of the Four Funds. The debt offerings that MS & Co. had done before 2003 were small-scale note offerings tied to the income streams from home alarm contracts, far different from the broad and non-specific investment mandate of Four Funds offerings.<sup>3</sup> Given Smith's lack of experience in this area, and the Respondents' knowledge of this lack of experience, they should have made specific inquiries as to how Smith planned to invest the offering proceeds. This is particularly true given fact that the issuers' ability to make the relatively high interest payments, and to return the investors' principal, depended on the nature of the investments;
- c. The PPMs stated that the Four Funds could acquire investments "from our managing member [MS Advisors] or any affiliate," could "purchase securities from issuers in offerings for which [MS & Co.] is acting as underwriter or placement agent," and that "[a]ffiliates of the placement agent may purchase a portion of the notes offered hereby." As a result, the Respondents should have inquired whether Smith—who controlled without oversight the issuers, the placement agent and the disposition of investor funds—did engage in any transactions with affiliates. If they had, they would have discovered that nearly half of the offering proceeds had been invested in affiliates; and
- d. Despite the complete prohibition on sales to unaccredited investors in the Four Funds PPMs, the Respondents knew that sales were being made to unaccredited investors. The Respondents, therefore, knew that the PPMs' prohibition on sales to unaccredited investors was disregarded, which should have caused them to make inquiries.

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<sup>3</sup> The Respondents, when recommending the Four Funds and Trust Offerings, held out the pre-2003 alarm note offerings as indicative of Smith and McGinn's integrity and skill. These earlier offerings, however, were also mismanaged. In a handwritten letter from Smith to McGinn in 2000, Smith characterized the pre-2003 offerings as a "Ponzi Scheme" because the offering proceeds "for the most part are used to fulfill the investment promise to earlier investors . . . the new investments have no chance of being repaid in full." These offerings were eventually paid off not from the income stream generated by the investments, but rather through the IASG IPO in July 2003, as well as over \$12 million from the Four Funds offerings.

39. These factors should have prompted the Respondents to conduct a searching inquiry into the offerings. Instead, they essentially turned a blind eye and sold the Four Funds offerings with no specific knowledge of how investor funds were being used.

**Smith’s Refusal to Disclose to the Brokers How He Had Invested Four Funds Offering Proceeds Was a Red Flag.**

40. From the commencement of the FIIN offering in September 2003 until January 2008, Smith provided his brokers with no specific information about how he had invested the offering proceeds. Any questions by the brokers were deflected with the claim that Smith had made loans to local Albany businesses with Four Funds proceeds, and those businesses desired anonymity. Indeed, Smith steadfastly refused to give the brokers any meaningful information about how he had invested the Four Funds offering proceeds. This refusal should have prompted the brokers to further question the propriety of the Four Funds.

41. The information blackout that Smith imposed was contrary to the PPMs, which stated that an “annual statement of the operations consisting of a balance sheet and income statement” would be provided to investors upon request. These reports, however, were never made available and it appears that no brokers requested this information before January 2008, when Smith disclosed that the Four Funds would be restructured.

42. MS & Co.’s compliance manual, moreover, stated that “it will make a reasonable investigation . . . [and] Paperwork recording the due diligence will be kept in the legal files.” The Respondents also never asked to see the due diligence files, notwithstanding the red flags regarding the Four Funds.

**The Respondents Continued to Recommend MS & Co. Offerings Despite Knowledge of the Redemption Policy – Another Major Red Flag.**

43. By 2006, the Funds began having significant difficulty in meeting the redemption requests. Smith therefore instituted a policy that required brokers to “replace” customers seeking to redeem Four Funds notes, including maturing notes, with new customers (the “Redemption Policy”). The PPMs, however, did not state that a customer’s right to redemption depended on finding a “replacement.”

44. The Redemption Policy was another red flag that put the Respondents on notice that the Four Funds were being handled much differently from what the PPMs provided. None of the Respondents, however, undertook any investigation of the offerings; they also failed to disclose this material information to their customers; and they continued to recommend MS & Co. private placements to their customers for several more years.

45. The Respondents learned of the policy at different times beginning in late 2006. They were shocked by the policy and knew that it was contrary to the PPMs. The Respondents, however, did not disclose the Redemption Policy to customers, even those who sought to reinvest, or “roll over,” Four Funds notes at maturity. Collectively, the Respondents raised millions of dollars in MS & Co. private placements after learning of the

policy. They stood to profit if a customer elected to roll over, and would receive their annual commission for the life of the note. The Respondents sought redemptions for current customers even knowing that the redemption would be paid not with investment returns, as the PPMs represented, but rather with new investor funds.

**The Respondents Continued to Sell the Trust Offerings Despite Learning in January 2008 that the Four Funds Had Been Mismanaged.**

46. On January 8, 2008, Smith and McGinn held an all-day meeting to inform the brokers, including the Respondents, that the Four Funds were in default, that payments to investors would be curtailed, and that the offerings would be restructured. Smith revealed that the Four Funds investment portfolios consisted of loans to small, local businesses, some of which had already filed for bankruptcy; risky venture capital investments; investments with sub-prime exposure; and other nonperforming investments. By contrast, the Four Funds each had made only one investment in a publicly-traded security: Exchange Boulevard.com, a risky venture capital company that was quoted on OTC Link, formerly known as the Pink Sheets.

47. None of the Respondents, despite the alarming disclosures in this meeting, requested any kind of probing investigation into what happened to the Four Funds or the ongoing Trust Offerings. After the January 2008 meeting, there were thirteen offerings by MSTF and the Trusts, which raised at least \$20 million. As a result of the accumulation of red flags since the launch of the Four Funds in September 2003, the Respondents should have conducted a searching inquiry regarding any MS & Co. private placement. Instead, they recommended the Trust Offerings to their customers based on insufficient due diligence.

48. During the three years of the Trust and MSTF Offerings, investor funds were being used in ways contrary to the uses described in the PPMs; for example, Smith and McGinn took at least \$4 million in offering proceeds for themselves and another MS & Co. officer. Offering proceeds also were used to pay investors in earlier offerings and MS & Co.'s payroll.

49. In the Trust Offerings, the amount actually invested pursuant to a particular PPM was far less than that PPM disclosed.

50. The Trust PPMs, moreover, like the Four Funds PPMs, raised red flags that should have been readily apparent to the brokers. For example, the August 2009 TDMM Benchmark Trust 09 ("Benchmark") PPM should have raised a red flag. Benchmark promised a high rate of return, which ranged from 8% to 12%, during a time when the prime rate was only 3.25%. The Respondents should have been skeptical of Benchmark's ability to meet the promised interest payments especially when considering that the PPM disclosed that only \$1,950,000 (approximately 65%) of the total \$3 million raised would actually be invested, with the remainder siphoned off in fees. The Respondents who recommended the Benchmark offering did so despite the exorbitant fees, and without questioning how MS & Co. planned to make 8 – 12% interest payments and redeem the principal upon maturity while taking over one-third of the money raised in fees.

51. The second Firstline Trust offering of October 19, 2007 raised \$3.2 million from investors (an earlier Firstline offering in May 2007 had raised \$3.7 million). In this offering, a McGinn Smith affiliate loaned the offering proceeds to Firstline Securities, Inc., a Utah corporation that sold residential alarm contracts. At the time of the October 2007 offering, McGinn had been informed of the threat of crippling litigation by one of Firstline's creditors, and McGinn was personally involved in trying to resolve the dispute. Litigation resulted and, on January 25, 2008, Firstline filed a voluntary petition for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the District of Utah. If the Respondents had conducted due diligence in response to red flags, they would have discovered the legal issues, which should have caused them to stop selling the Firstline offering. Instead, they were unaware of the bankruptcy filing until McGinn finally disclosed it in September 2009. Lex, Feldmann, Chiappone, Rabinovich and Mayer sold Firstline trust certificates after the bankruptcy filing.

#### **F. SALES AND COMMISSIONS**

52. **Anthony** sold approximately \$2.2 million of the Four Funds, and approximately \$630,000 of the Trust Offerings. He earned approximately \$104,000 in commissions.

53. **Chiappone** sold approximately \$12 million of the Four Funds offerings and approximately \$3.4 million of the Trust Offerings. He earned approximately \$513,000 in commissions.

54. **Feldmann** sold approximately \$5.4 million of the Four Funds offerings and approximately \$595,000 of the Trust Offerings. Feldmann earned approximately \$299,000 in commissions.

55. **Gamello** sold approximately \$1.3 million of the Four Funds offerings and approximately \$1.6 million of the Trusts. He earned approximately \$74,500 in commissions.

56. **Lex** sold approximately \$38.5 million of the Four Funds offerings and approximately \$6.6 million of the Trust Offerings. He earned approximately \$1,523,000 in commissions.

57. **Livingston** sold approximately \$3.5 million of the Four Funds offerings and approximately \$380,000 of the Trust Offerings. His total commissions were approximately \$143,000.

58. **Mayer** sold approximately \$1.7 million of the Four Funds offerings and approximately \$1.9 million of the Trust Offerings. He earned approximately \$81,000 in commissions, plus an additional 2% of the gross commissions generated by the New York City office.

59. **Rabinovich** sold approximately \$20.3 million of the Four Funds offerings and approximately \$6.8 of the Trust Offerings. He earned approximately \$578,000 in commissions.

60. **Rogers** sold approximately \$2 million of the Four Funds and approximately \$5.2 million of the Trust Offerings. He earned approximately \$240,000 in commissions.

#### **G. GUZZETTI FAILED REASONABLY TO SUPERVISE**

61. Guzzetti was the managing director of the MS & Co. Private Client Group from 2004 until late 2009. During this period, Guzzetti supervised MS & Co. registered representatives with regard to the Four Funds and Trust Offerings.

62. Guzzetti, who also earned about \$6,000 in commissions, had direct supervisory responsibilities of the Respondents. He carried out numerous managerial duties, including recruiting and hiring MS & Co. employees; assigning and reassigning customers to brokers; evaluating employee performances and awarding commissions; addressing customer grievances; answering employee questions regarding the firm; and issuing instruction and guidance regarding specific financial products and transactions, administrative issues, and broader firm policy.

63. Guzzetti also sent regular e-mails summarizing MS & Co. products available for sale to customers. In a February 2006 email, for example, Guzzetti stated that “there are many investors sitting in money market accounts (fear of higher interest rates) who are losing return (cost of waiting). Our FAIN’S offer a way of locking in higher returns with \$ sitting in money markets waiting for the ‘top’ in interest rates.”

64. Guzzetti learned of the Redemption Policy by December 2006, when he received an email from Smith stating that Rabinovich “needs to replace the \$100,000 before doing the trade. I am running on fumes with all of these redemptions and cannot afford any[.]more.” In November 2007, Guzzetti received an email from Smith stating that “I do not have the liquidity. Any redemptions have to have replacement sales beforehand. . . My preference is for there to be no redemptions.” Guzzetti instructed the brokers to adhere to the Redemption Policy.

65. Guzzetti had a duty to investigate red flags that suggest misconduct may be occurring and to take action when made aware of suspicious conduct. Had Guzzetti responded reasonably to the red flags, he would have prevented or detected the underlying violations committed by Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers.

#### **H. VIOLATIONS**

66. As a result of the conduct described above, Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers willfully violated Sections 5(a) and (c) of the Securities Act.

67. As a result of the conduct described above, Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers willfully violated Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

68. As a result of the conduct described above, Guzzetti failed reasonably to supervise Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers, pursuant to Section 15(b)(6), incorporating by reference Section 15(b)(4)(E) of the Exchange Act, with a view toward preventing and detecting their violations of Sections 5(a) and (c) and 17 of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

E. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondents Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Rogers should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 5(a), (c) and 17(a) of the Securities Act, and Section 10(b) and Rule 10b-5 of the Exchange Act, whether Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Respondents Anthony, Chiappone, Feldmann, Gamello, Lex, Livingston, Mayer, Rabinovich and Roger should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act.

### IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not

later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy  
Secretary