HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-18791

In the Matter of **TRAVIS A. BRANCH,** **Respondent.**	**DECLARATION OF DOUGLAS M. MILLER IN SUPPORT OF DIVISION OF ENFORCEMENT'S MOTION FOR ENTRY OF DEFAULT AND SANCTIONS**

I, Douglas M. Miller, declare pursuant to 28 U.S.C. § 1746 as follows:

1. I am an attorney admitted to practice law by the State Bar of California and by this Court. I am currently a Senior Trial Counsel with Plaintiff Securities and Exchange Commission's ("SEC") Los Angeles Regional Office. I have personal knowledge of the matters set forth herein, except as otherwise noted, and, if called as a witness, I could and would competently testify under oath to the facts stated herein.

2. I make this declaration in support of the Division of Enforcement's Motion for Entry of Default and Sanctions.

3. As of this filing, I have not received from Respondent an answer to the OIP or any responses to the Commission's May 30 and July 2, 2019 orders.

4. Attached as **Exhibit 1** is a true and correct copy of the Amended Final Judgment issued against Respondent in the Southern District of Florida on August 7, 2018.

5. Attached as **Exhibit 2** is a true and correct copy of the civil complaint the SEC filed against Respondent in the Southern District of Florida in May 2009.

6. Attached as **Exhibit 3** is a true and correct copy of the findings of fact and conclusions of law issued by United States District Judge Kenneth A. Marra in the Southern District of Florida on March 29, 2018.

7. Attached as **Exhibit 4** is a true and correct copy of the Order Instituting Public Administrative Proceedings ("OIP") against Respondent on September 19, 2018.

8. Attached as **Exhibit 5** is a true and correct copy of the Commission's May 10, 2019 Order Regarding Service.

9. Attached as **Exhibit 6** is a true and correct copy of the Division's May 28, 2019 status report regarding service.

10. Attached as **Exhibit 7** is a true and correct copy of the Commission's May 30, 2019 Order to Show Cause.

11. Attached as **Exhibit 8** is a true and correct copy of the Respondent's June 13, 2019 Response to Order to Show Cause.

12. Attached as **Exhibit 9** is a true and correct copy of the Division's June 26, 2019 Reply to Order to Show Cause.

13. Attached as **Exhibit 10** is a true and correct copy of the Commission's July 2, 2019 Order Requesting Additional Written Submissions.

14. Attached as **Exhibit 11** is a true and correct copy of an email communication I wrote on October 10, 2018, concerning a telephone conversation I had with an individual who identified himself as Corey Branch, Respondent's brother.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed this 13th day of August, 2019 in Los Angeles, California.

DOUGLAS M. MILLER

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-18791

In the Matter of

Travis A. Branch

Respondent.

CERTIFICATE OF SERVICE

Douglas Miller, an attorney, hereby certifies that on August 13, 2019, caused a true and correct copy of **DECLARATION OF DOUGLAS M. MILLER IN SUPPORT OF DIVISION OF ENFORCEMENT'S MOTION FOR ENTRY OF DEFAULT AND SANCTIONS** to be served on the following via UPS Next Day Air:

Mr. Travis A. Branch, *pro se*
44-672 Kahinani Place No. 11
Kaneohe, Hawaii 96744

Dated: August 13, 2019

Douglas Miller
Division of Enforcement
Securities and Exchange Commission
Los Angeles Regional Office
444 South Flower Street, Suite 900
Los Angeles, California 90071

EXHIBIT 1

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 09-80803-CIV-MARRA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

WILLIAM BETTA, JR., TRAVIS A. BRANCH, JAMES J. CAPRIO, TROY L. GAGLIARDI, RUSSELL M. KAUTZ, BARRY M. KORNFELD, SHANE A. MCCANN, CLIFFORD A. POPPER, ALFRED B. RUBIN, and STEVEN I. SHRAGO,

Defendants.
_____/

AMENDED FINAL JUDGMENT

In accordance with the Court's Order granting in part William Betta's Motion for Reconsideration, for New Trial, to Vacate Final Judgment and Reopen Case for New Evidence, and/or to Amend Final Judgment [DE 388], it is hereby

ORDERED AND ADJUDGED that Final Judgment be and the same is hereby ENTERED in favor of Defendants Troy L. Gagliardi, Russell M. Kautz, Shane A. McCann, Alfred B. Rubin and Steven I. Shrago and against the Commission as to these five Defendants. The Commission shall take nothing from Troy L. Gagliardi, Russell M. Kautz, Shane A. McCann, Alfred B. Rubin and Steven I. Shrago. It is further

ORDERED AND ADJUDGED that Final Judgment be and the same is hereby ENTERED in favor of the Commission and against William Betta Jr. and Travis A. Branch. Branch is permanently restrained and enjoined from violating, directly or

indirectly, § 10(b) of the Securities Exchange Act o 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, by using any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with the purchase or sale of any security;

(A) to employ any device, scheme, or artifice to defraud;

(B) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(C) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Branch is liable for disgorgement of the commissions earned from the Osiecki's account for the period while the account was on margin, together with prejudgment interest as of the date of the filing of the complaint. There is insufficient evidence in the record for the Court to determine this amount. The Court retains jurisdiction to conduct further proceedings to determine the amount of commissions Branch earned from the Osiecki's account while their account was on margin. The Court exercises its discretion to not impose a civil penalty against Branch.

No injunction is issued as to Betta. Betta is liable for disgorgement of an amount to be determined after additional proceedings, together with prejudgment interest as of the date of the filing of the complaint. The Court does not find that Betta should be required to disgorge all commissions he earned from the CMO

Program. A more refined determination of the amount of his liability for disgorgement is necessary. The Court retains jurisdiction to conduct further proceedings to determine that amount. The Court exercises its discretion to not impose a civil penalty against Betta.

The Court retains jurisdiction of this matter for the purposes of enforcing the terms of this Final Judgment. This case is closed.

DONE AND ORDERED in Chambers at West Palm Beach, Palm Beach County, Florida, this 7th day of August, 2018.

KENNETH A. MARRA
United States District Judge

EXHIBIT 2

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. **09-80803-Civ-MARRA/JOHNSON**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

WILLIAM BETTA, JR., TRAVIS A. BRANCH, JAMES J. CAPRIO, TROY L. GAGLIARDI, RUSSELL M. KAUTZ, BARRY M. KORNFELD, SHANE A. MCCANN, CLIFFORD A. POPPER, ALFRED B. RUBIN, and STEVEN I. SHRAGO,

Defendants.

COMPLAINT FOR INJUNCTIVE AND OTHER RELIEF

Plaintiff Securities and Exchange Commission (the "Commission") alleges as follows:

SUMMARY

1. The Commission brings this action to restrain and permanently enjoin William Betta, Jr., Travis A. Branch, James J. Caprio, Troy L. Gagliardi, Russell M. Kautz, Barry M. Kornfeld, Shane A. McCann, Clifford A. Popper, Alfred B. Rubin, and Steven I. Shrago (collectively, "Defendants") from violating the antifraud provisions of the federal securities laws.

2. Between 2004 and 2007, Defendants, formerly registered representatives at Brookstreet Securities Corp. ("Brookstreet"), made false and misleading statements in connection with the offer, sale, or purchase of certain types of Collateralized Mortgage Obligations ("CMOs"). Defendants told their customers that the CMOs in which they would invest were safe, secure, liquid investments that were suitable for retirees, retirement accounts, and investors with conservative investment goals. Contrary to what they told customers, between 2004 and 2007 Defendants invested in risky types of CMOs that: (1) were not all guaranteed by the United States government; (2) jeopardized customers' yield and principal; (3) were largely illiquid; and (4) were only suitable for sophisticated investors with a high-risk

investment profile. In addition, Defendants heavily margined customers' accounts (up to a ten to one margin to equity ratio), making the CMOs in which they invested even more sensitive to changes in interest rates and downturns in the CMO market.

3.e Defendants' fraudulent misrepresentations and omissions attracted more thane 750 investor accounts with CMO investments of more than $175 million.

4.e Beginning in early 2007, the CMO market began to fail, resulting in significante losses for Defendants' customers and margin calls for those customers on margin. By June 2007, the margin calls had snowballed to the point where Brookstreet failed to meet its net capital requirements, causing the company to cease operations. Many of Defendants' CMO customers lost their savings, their homes, and/or their ability to retire or stay retired. In addition, many margined CMO customers ended up owing Brookstreet's clearing firm hundreds of thousands of dollars.

5.e By engaging in the conduct described in this Complaint, Defendants have violatede Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a), and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. Unless enjoined, Defendants are likely to commit such violations in the future.

6.e The Commission seeks a judgment from the Court: (a) enjoining Defendants frome engaging, directly or indirectly, in further violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (b) ordering Defendants to disgorge, with prejudgment interest, the amount by which they were unjustly enriched as a result of their violations of the federal securities laws; and (c) ordering Defendants to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

DEFENDANTS

7.e **William Betta, Jr.**, age 36, resides in Boca Raton, Florida. Between May 2004e and June 2007, Betta was a registered representative in Brookstreet's Boca Raton office and was the "broker liaison" for the office. He holds Series 7 and 63 securities licenses. Betta is

currently a registered representative with Workman Securities Corp., a registered broker-dealer and investment adviser.

8.e **Travis A. Branch**, age 54, resides in Kailua, Hawaii. Branch was a registerede representative in Brookstreet's Honolulu office from February 1995 to June 2007. He holds Series 6, 7, 22, 24, and 63 securities licenses. Branch currently sells insurance and performs tax consulting through his private company.

9. **James J. Caprio**, age 46, resides in Weston, Florida. Caprio was branch managere in Brookstreet's Boca Raton office from January 2004 to November 2005, and a registered representative in that office from January 2004 to January 2006. He holds Series 4, 7, 24, 63, and 65 securities licenses. In 2006, Caprio was enjoined from future violations of Sections 5(a) and 5(c) of the Securities Act and Section 13(d) of the Exchange Act, and Rules 13d-1 and 13d-2 thereunder, for selling unregistered securities and failing to file a Schedule 13D report after obtaining more than 5% of a public company. *In re Caprio*, Rel. No. 34-53178 (Jan. 25, 2006). Caprio paid a $125,000 civil penalty and was suspended from associating with a broker-dealer for six months. *Id.* Caprio currently works as a commercial real-estate broker.

10.e **Troy L. Gagliardi**, age 37, resides in Boca Raton, Florida. Gagliardi was branche manager of Brookstreet's Boca Raton office from March 2006 to June 2007, and a registered representative in Brookstreet's Jericho, Deer Park, and Boca Raton offices from August 1999 to June 2007. He holds Series 4, 7, 24, 63, 65, and 66 securities licenses. Gagliardi is currently a registered representative with Newbridge Securities Corp., a registered broker-dealer, and an investment adviser representative with Newbridge Financial Services Group, Inc., a registered investment adviser.

11.e **Russell M. Kautz**, age 51, resides in Medford, Oregon. Kautz was a registerede representative in Brookstreet's Medford office from January 2003 through June 2007. He holds Series 7, 24, 31, 63, and 65 securities licenses. Kautz is currently a registered representative and investment adviser with Wedbush Morgan Securities Inc., a registered broker-dealer and investment adviser.

12.e **Barry M. Kornfeld**, age 46, resides in Parkland, Florida. Kornfeld was ae registered representative at Brookstreet's Coral Springs office from January 2004 to June 2007, and a branch manager in that office from January 2004 to June 2006. He holds Series 4, 7, 24, 31, 63, and 66 securities licenses. Kornfeld is currently a commercial real-estate broker.

13.e **Shane A. McCann**, age 41, resides in Florence, Montana. McCann was ae registered representative in Brookstreet's Missoula office from June 2002 to June 2007. He holds Series 6, 7, and 63 securities licenses. McCann is currently a registered representative at Pacific West Securities, Inc., a registered broker-dealer and investment adviser.

14.e **Clifford A. Popper**, age 51, resides in Highland Beach, Florida. Popper was ae registered representative in Brookstreet's Boca Raton office from January 2004 to June 2007. He holds Series 7 and 63 securities licenses. Popper is currently unemployed.

15.e **Alfred B. Rubin**, age 55, resides in Pompano Beach, Florida. Rubin was ae registered representative in Brookstreet's Coral Springs office from January 2004 to June 2007, and a branch manager in that office from June 2006 to June 2007. He holds Series 6, 7, 24, 63, and 66 securities licenses. Rubin is currently unemployed.

16.e **Steven I. Shrago**, age 49, resides in St. Petersburg, Florida. Shrago was ae registered representative in Brookstreet's St. Petersburg office from January 2001 to June 2007. He holds Series 3, 7, 24, 53, 63, and 65 securities licenses. Shrago is currently a registered representative and an investment adviser representative with Wedbush Morgan Securities Inc., a registered broker-dealer and investment adviser.

OTHER RELEVANT ENTITY

17.e **Brookstreet Securities Corp.** was a California corporation headquartered ine Irvine, California, and was a dually registered broker-dealer and investment adviser. Brookstreet was controlled by Stanley C. Brooks and the Brooks Family Trust. Brookstreet operated numerous independent offices nationwide, including Defendants' offices. From at least January 2004 through June 2007, Brookstreet had an agreement with a clearing broker-dealer to execute all of Brookstreet's securities transactions and maintain its customer accounts. In June 2007, Brookstreet failed to meet its net capital requirements and ceased operations.

JURISDICTION AND VENUE

18.e The Court has jurisdiction over this action pursuant to Sections 20(b), 20(d), ande 22(a) of the Securities Act, 15 U.S.C. §§ 77t(b), 77t(d), and 77v(a), and Sections 21(d), 21(e), and 27 of the Exchange Act, 15 U.S.C. §§ 78u(d), 78u(e), and 78aa. Defendants, directly or indirectly, made use of the means or instrumentalities of interstate commerce, or of the mails, or of the facilities of a national securities exchange, in or in connection with the transactions, acts, practices, and courses of business alleged in this Complaint.

19.e Venue is proper in the Southern District of Florida pursuant to Section 22(a) ofe the Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because certain of the transactions, acts, practices, and courses of business constituting violations of the federal securities laws occurred within this district. In addition, Betta, Caprio, Gagliardi, Kornfeld, Popper, and Rubin resided in this district during the events described in this Complaint.

THE FRAUDULENT SCHEME

A. The CMO Program

20.e From January 2004 to June 2007, Brookstreet sponsored the CMO Program,e which allowed Defendants to invest their customers' funds in CMOs. In recommending CMOs and the CMO Program to customers, Defendants made material misrepresentations and omissions.

21.e A CMO is a security that is collateralized by mortgage-backed securitiese ("MBS"), which in turn are undivided interests in a pool of mortgages. The principal and interest from the mortgages underlying a MBS are used to pay CMO investors principal and/or interest, depending on the type, or "tranche," of CMO that they own. CMOs are classified, in part, based on the entity that guarantees them. CMOs guaranteed by Ginnie Mae, a government agency, carry no credit risk. During the relevant period, CMOs guaranteed by Fannie Mae or Freddie Mac, both government-sponsored entities ("GSEs"), carried some credit risk because they were not backed by the full faith and credit of the United States government. CMOs guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac are referred to as "agency" CMOs.

"Non-agency" CMOs are guaranteed solely by private institutions and carry the credit risk associated with those private institutions.

22.e The self-described "Institutional Bond Group," located in Brookstreet's Bocae Raton office, controlled the CMO Program. Popper managed and directed the Institutional Bond Group. Caprio, Gagliardi, and Betta worked in the Institutional Bond Group as its staff and as registered representatives for their own customers. The Institutional Bond Group was the conduit through which all CMO trades occurred at Brookstreet. Defendants could only trade CMOs in and out of their customers' accounts by funneling trades through the Institutional Bond Group.

23.e The Institutional Bond Group used seminars at Brookstreet's annual producte marketing conferences, internal email distributions, and conference calls to solicit registered representatives located at other Brookstreet offices, including Branch, Kautz, Kornfeld, McCann, Rubin, and Shrago, to participate in the CMO Program.

24.e Those Brookstreet registered representatives who wanted to participate in thee CMO Program contacted the Institutional Bond Group to have their customers' accounts "designated for management." Only Popper, Caprio, Gagliardi, and Betta were part of the Institutional Bond Group, but Branch, Kautz, Kornfeld, McCann, Rubin, and Shrago participated in the CMO Program.

25.e Popper was the director of the Institutional Bond Group and the architect of thee CMO Program: he selected CMOs for purchase or sale; traded them with traders at other institutions; and made CMO recommendations to Brookstreet customers through their registered representatives. Popper styled himself as a CMO expert and positioned himself as the "Portfolio Manager" for the CMO Program. In addition, Popper was a registered representative for sixty-eight of his own CMO Program customer accounts.

26.e Betta was the Institutional Bond Group's "broker liaison," and he communicatede with other Brookstreet registered representatives on Popper's behalf. Betta's primary role as broker liaison was to convey Popper's CMO trade recommendations to registered representatives. Betta also educated other registered representatives on CMOs. Betta had only a

few of his own CMO Program customer accounts, but he spoke directly with other registered representatives' customers and made representations to them about the characteristics of CMOs.

27. Caprio (January 2004 to November 2005) and Gagliardi (March 2006 toe June 2007) served as the supervisors for Brookstreet's Boca Raton office, which housed the Institutional Bond Group. In addition to their supervisory roles within the office, Caprio and Gagliardi were registered representatives with 125 and 31 CMO Program customer accounts, respectively.

28.e Branch, Kautz, Kornfeld, McCann, Rubin, and Shrago participated in the CMOe Program as registered representatives and recommended CMOs to their customers. Branch had 32 CMO Program customer accounts, Kautz had 13, Kornfeld had 228, McCann had 17, Rubin had 232, and Shrago had 27.

B. <u>The Types of CMOs Traded in the CMO Program</u>

29.e CMOs come in myriad varieties, each with its own yield, price volatility, and riske characteristics. However, the vast majority of CMOs traded in the CMO Program were risky and sensitive to changes in market interest rates.

30. Approximately 90% of all CMO purchases (weighted by price and volume) ate Brookstreet between January 2004 and June 2007 were inverse floating rate CMOs ("Inverse Floaters"), interest only CMOs ("IOs"), and inverse interest only CMOs ("Inverse IOs"). Among these three types of CMOs (hereinafter referred to as "Program CMOs"), 86% were agency CMOs and 14% were non-agency CMOs.

31.e Inverse Floaters are variable rate securities with a coupon that is inversely relatede to a short-term interest rate index, typically the London Interbank Offered Rate ("LIBOR"). As the index's interest rates rise, the Inverse Floater's interest payment falls, and vice versa. Inverse Floaters can have poor liquidity and erratic pricing. Inverse Floaters purchased for a premium (i.e., at a price over par) or sold before maturity present price risk to investors (i.e., the investor can lose their original investment).

32.e IOs are risky securities because they have no principal component and paye investors solely from the interest payments on the mortgage pool underlying a MBS. IOs are

sensitive to market interest rate changes. When market interest rates fall, homeowners tend to prepay their loans, thereby reducing the number of mortgages available in the underlying pool to make interest payments. If enough mortgages underlying an IO prepay, the entire tranche may "expire" early, resulting in a loss for investors who had not already recouped their initial investment through the interest payments.

33.e Inverse IOs are a hybrid of Inverse Floaters and IOs. Like IOs, Inverse IOs havee no principal component and investors are paid solely from the underlying MBS' interest payments. Like Inverse Floaters, the interest payment for Inverse IOs moves in the opposite direction of a specific short-term interest rate index. In all but limited interest rate environments (e.g., falling short-term interest rates, but neutral or rising long-term interest rates), Inverse IOs display the negative characteristics of both Inverse Floaters and IOs; their price is sensitive to changes in the market interest rate and investors risk losing their investment.

34.e These three types of CMOs are among the riskiest available and are generally note suitable for retail investors. Accordingly, in 1993, the NASD issued *Notice to Members 93-73: Member's Obligations to Customers When Selling Collateralized Mortgage Obligations (CMOs)* ("*NASD Notice 93-73*"), which stated that Inverse Floaters are "only suitable for sophisticated investors with a high-risk profile," and dictated that members could sell IOs "only to sophisticated investors maintaining a high-risk profile."

C. The CMO Trading Process

35.e The Institutional Bond Group conducted CMO trades on behalf of all CMOe Program customers. Popper selected each CMO that was traded within the CMO Program. The Institutional Bond Group communicated Popper's CMO selections and proposed CMO trades to the registered representatives, including Defendants, who signed trade tickets to confirm that their customers approved the trade.

36.e Popper typically traded institutional-sized blocks (i.e., "round lots") of CMOs.e After a CMO purchase, the Institutional Bond Group broke these round lots into smaller, "odd lot" positions for distribution into customers' accounts. Prior to a sale, the Institutional Bond Group would aggregate customers' odd lot CMO positions into round lots, which were more

easily sold into the market.

37.e CMO Program customers sometimes requested that Defendants sell their CMOe positions outside of Popper's standard sale process. These customers faced liquidity problems and delays of up to one year due to the fact that they typically held odd lot positions. As a result, customers either had to cross-trade with other Brookstreet customers or wait until Popper decided to aggregate their CMOs with other customers' positions to sell a round lot to the market.

38.e None of the Defendants had actual discretionary authority over their customers'e accounts. In practice, however, Defendants had complete control over customers' CMO trades; Defendants did not always seek authorization from customers before executing a CMO trade, and customers generally relied upon Defendants' "expertise" to manage their accounts because they did not understand Program CMOs.

39.e Defendants heavily leveraged the accounts of CMO Program customers whoe agreed to use margin. In June 2006, after Brookstreet's clearing firm relaxed its house margin requirements for Inverse Floaters and IOs, Defendants began leveraging their customers' CMO Program accounts up to 90% (e.g., an account with $100,000 in equity would be able to purchase $1,000,000 of CMOs).

40.e Defendants received commissions on the CMO trades (see Table below). Bettae also received a salary of $2.3 million over four years for his role as the CMO Bond Group's broker liaison.

Defendants' CMO Accounts, Use of Margin, and Commissions: 2004 – 2007

Defendant	*CMO Accounts*	*Margin Accounts*	*Accounts in Deficit*	*Total Amount of Deficits*	*CMO Commissions*
William Betta, Jr.	2	0	0e	$0	$21,318
Travis A. Branch	32	21	16	$3,202,035	$481,895
James J. Caprio	125	77	4	$143,487	$956,636
Troy L. Gagliardi	31	16	11	$12,102,581	$3,388,645
Russell M. Kautz	13	6	5	$1,840,038	$344,770

Barry M. Kornfeld	228	46	25	$5,313,790	$2,363,729
Shane A. McCann	17	4	3	$1,061,444	$407,748
Clifford A. Popper	68	30	12	$10,925,123	$6,827,714
Alfred B. Rubin	232	44	23	$4,963,830	$1,259,843
Steven I. Shrago	27	5	2	$201,221	$186,607
Totals	***775***	***249***	***101***	***$39,753,549***	***$16,238,905***

D.e Material Misrepresentations and Omissionse

41.e Defendants made material misrepresentations and/or failed to disclose materiale information to prospective and established customers about Program CMOs and the CMO Program.

42.e Some Defendants misrepresented to customers that Program CMOs were backede by the United States government. For example:

- **Betta.** In December 2003 and June 2004, in Boca Raton, Florida, Bettae represented to customers that Program CMOs were guaranteed by the federale government. Betta also called Program CMOs "government bonds."e
- **Branch.** In February and May 2005, and October 2006, in Honolulu, Hawaii,e Branch represented to customers that Program CMOs were guaranteed by thee federal government.e
- **Caprio.** In late 2004, in Boca Raton, Florida, Caprio represented to ae customer that Program CMOs were issued by government or quasi-government agencies. In December 2003, in Boca Raton, Florida, Caprioe represented to a customer that Program CMOs were backed by the Unitede States government.e
- **Gagliardi.** In April 2004, on a telephone call with a customer located ine England, Gagliardi represented that Program CMOs were backed by thee United States Government. In September 2004, in New York, Gagliardie represented to a customer that Program CMOs were "government backede

mortgage bonds." In November 2004, in New York, Gagliardi represented to a customer that Program CMOs were "government guaranteed" and referred to them as "government bonds."

- **Kautz.** In May and September 2005, in Medford, Oregon, Kautz representede to customers that Program CMOs were guaranteed by the federal governmente and that they were "government-backed AAA-rated bonds."e
- **Kornfeld.** In 2003 and 2005, in Coral Springs, Florida, Kornfeld representede to customers that Program CMOs were guaranteed by the federal government.e In June 2005, in Coral Springs, Florida, Kornfeld told a customer thate Program CMOs were "AAA government bonds."e
- **Popper.** In June 2007, Popper represented to a customer that the principale and interest for Program CMOs were guaranteed by government agencies. Ine 2000, 2001, and 2003, in Boca Raton, Florida, Popper represented toe customers that Program CMOs were backed by the United States government.e
- **Rubin.** In July 2004 and January 2006, in Coral Springs, Florida, Rubine represented to customers that Program CMOs were backed by the Unitede States government.e
- **Shrago.** In December 2004, in St. Petersburg, Florida, Shrago represented toe a customer that Program CMOs were government backed. Shrago also callede Program CMOs "government bonds."e

In fact, from at least 2004 to 2007, Defendants invested CMO Program customers' funds in both agency and non-agency CMOs. During the relevant period, only Ginnie Mae CMOs carried a government guarantee.

43.e Defendants misrepresented to customers that Program CMOs presented low or noe risk to principal. For example:

- **Betta.** In October and December 2003, and June 2004, in Boca Raton,e Florida, Betta represented to customers that Program CMOs presented no riske to principal and/or could not lose principal. In October and December 2003,e

Betta represented to customers that the worst thing that could happen with Program CMOs is that the customers would have to wait until they matured to get their entire principal back.

- **Branch.** In February 2005, in Honolulu, Hawaii, Branch represented too customers that the safety of principal was guaranteed with Program CMOs.o
- **Caprio.** In October and December 2003, and February 2004, in Boca Raton,o Florida, Caprio represented to customers that Program CMOs presented no o risk to principal and/or could not lose principal. In October and Decembero 2003, Caprio represented to customers that the worst thing that could happeno with Program CMOs is that the customers would have to wait until their investment matured to get their entire principal back.o
- **Gagliardi.** In September 2004, in New York, Gagliardi represented to ao customer that Program CMOs could not lose principal unless the Unitedo States economy failed. In April 2004, in New York, Gagliardi represented too a customer that Program CMOs protected principal.o
- **Kautz.** In May and September 2005, and January 2006, in Medford, Oregon,o Kautz represented to customers that Program CMOs presented low or no risko to principal.o
- **Kornfeld.** In 2003 and 2005, in Coral Springs, Florida, Kornfeld representedo to customers that Program CMOs had no risk to principal and/or wereo completely safe.o
- **McCann.** In August 2004 and June 2005, in Missoula, Montana, McCanno represented to customers that Program CMOs were safe and AAA-rated.o
- **Popper.** In 2004, in Boca Raton, Florida, Popper represented to a customero that CMOs were a low risk, safe investment. In 2001 and October and December 2003, in Boca Raton, Florida, Popper represented to customers that Program CMOs presented no risk to principal and could not lose principal. In October and December 2003, Popper represented to customers that the worst

thing that could happen with Program CMOs is that the customers would have to wait until they matured to get their entire principal back.

- **Rubin**. In 2003, 2004, and 2006, in Coral Springs, Florida, Rubin representede to customers that Program CMOs had little to no risk to principal.e
- **Shrago**. In November 2003, in St. Petersburg, Florida, Shrago represented toe a customer that Program CMOs were safe and as secure as certificates ofe deposit.e

In fact, from at least 2004 to 2007, Defendants knew, or were severely reckless in not knowing, that changes in interest rates and/or prepayment speeds could result in large fluctuations in Program CMO prices and a loss of principal for IOs or any Inverse Floaters that customers bought at a premium or sold prior to maturity.

44.e Some Defendants misrepresented to customers that Program CMOs were easilye sold and/or could be liquidated within thirty to ninety days. For example:

- **Betta**. In October 2003, in Boca Raton, Florida, Betta represented to ae customer that Program CMOs could be easily sold within thirty days, bute failed to disclose that Program CMOs were not liquid because they weree exotic tranches of CMOs and because the customer would hold odd lote positions.e
- **Caprio**. In October 2003 and February 2004, in Boca Raton, Florida, Caprioe represented to customers that Program CMOs could be easily sold upone request or within thirty days, but failed to disclose that Program CMOs weree less liquid because they were exotic tranches of CMOs and because thee customer would hold odd lot positions.e
- **Gagliardi**. In April and September 2004, in New York, Gagliardi representede to customers that Program CMOs were easily traded and could be sold at anye time.e
- **Kautz**. In May and September 2005, in Medford, Oregon, Kautz representede to customers that Program CMOs were liquid investments.e

- **Kornfeld**. In 2003, in Coral Springs, Florida, Kornfeld represented to ao customer that Program CMOs could be sold quickly. In October 2006, ino Coral Springs, Florida, Kornfeld represented to customers that he wouldo liquidate their Program CMO account immediately, but he did not do so foro several months.o
- **McCann**. In August 2004, in Missoula, Montana, McCann represented to ao customer that the CMO Program distributed odd lots of Program CMOs too customers' accounts, but failed to disclose that this made Program CMOs lesso liquid.o
- **Popper**. In 2001, in Boca Raton, Florida, Popper told a customer thato Program CMOs were liquid because there was a huge market for them. Ino October 2003, in Boca Raton, Florida, Popper represented to a customer thato Program CMOs could be easily sold within thirty days, but failed to discloseo that Program CMOs were less liquid because they were exotic tranches ofo CMOs and because the customer would hold odd lot positions.o
- **Rubin**. In July 2004, in Coral Springs, Florida, Rubin represented to ao customer that Program CMOs were easily traded. In January 2006, in Coralo Springs, Florida, Rubin represented to a customer that Program CMOs couldo be liquidated within a month. In October 2006, in Coral Springs, Florida,o Rubin represented to customers that he would liquidate their Program CMOo account immediately, but did not do so for several months.o
- **Shrago**. In November 2003, in St. Petersburg, Florida, Shrago represented too a customer that Program CMOs could be sold with 24 hours' notice and thato an entire account could be liquidated within sixty days.o

In fact, from at least 2004 to 2007, Defendants knew, or were severely reckless in not knowing, that Program CMOs were largely illiquid because they were exotic tranches of CMOs and because customers held them in odd lot, rather than round lot, positions. Many customers waited more than three months, and some more than a year, for Defendants to liquidate their Program

CMOs.

45. Defendants misrepresented to customers that Program CMOs were safe and appropriate for retirees, retirement accounts, and/or investors with conservative investment objectives. For example:

- **Betta.** In October and December 2003, and June 2004, in Boca Raton, Florida, Betta represented to customers that Program CMOs were safe investments that were appropriate for investors with conservative investment objectives. In October 2003, in Boca Raton, Florida, Betta represented to a customer that Program CMOs were a safe investment for the customer's college education fund.
- **Branch.** In February 2005, in Honolulu, Hawaii, Branch represented to a customer that Program CMOs were safe and appropriate for retirees, retirement accounts, and investors with conservative investment objectives.
- **Caprio.** In February 2004, in Boca Raton, Florida, Caprio represented to a customer that Program CMOs were safe and appropriate for a retirement account.
- **Gagliardi.** In September 2004, in New York, Gagliardi represented to a customer that Program CMOs were safe and were an appropriate investment for a retirement account.
- **Kautz.** In May and September 2005, and January 2006, in Medford, Oregon, Kautz represented to customers that Program CMOs were safe and were an investment appropriate for their retirement funds.
- **Kornfeld.** In 2003 and 2005, in Coral Springs, Florida, Kornfeld represented to customers that Program CMOs were safe and were an appropriate investment for retirement funds.
- **McCann.** In August 2004 and June 2005, in Missoula, Montana, McCann represented to customers that Program CMOs were a safe investment and allowed recommended Program CMOs to retirees and for retirement accounts.

- **Popper.** In 2004, in Boca Raton, Florida, Popper represented to a customero that CMOs were a safe investment for a retirement account. In 2001 ando 2003, in Boca Raton, Florida, Popper represented to customers that Programo CMOs were safe and were an appropriate investment for retirement funds.
- **Rubin.** In 2003, 2004, and 2006, in Coral Springs, Florida, Rubin representedo to customers that Program CMOs were safe and were an appropriateo investment for retirement funds.o
- **Shrago.** In August and December 2004, in St. Petersburg, Florida, Shragoo represented to customers that Program CMOs were a safe investment and were suitable for retirees.o

In fact, from at least 2004 to 2007, Defendants knew, or were severely reckless in not knowing, that Program CMOs were only suitable for sophisticated investors with a high-risk profile.

46.o Some Defendants misrepresented to customers that margin would be usedo sparingly and/or posed little or no risk to customers' principal. Some Defendants misrepresented to customers that buying Program CMOs on margin would reduce their overall risk by allowing them to have a more diverse CMO portfolio. Some Defendants misrepresented that they would take their customers off of margin, but failed to do so. Some Defendants invested their customers' funds using margin without notice. For example:

- **Betta.** In 2006, in Boca Raton, Florida, Betta represented to a customer thato he would take the customer's account off of margin, but he did not do so.o
- **Branch.** In October 2006, in Honolulu, Hawaii, Branch represented to ao customer that investing in Program CMOs with a high margin balance was safer than no or a low margin balance because using margin afforded moreo buying power.o
- **Caprio.** Between 2004 and 2007, in Boca Raton, Florida, Caprio representedo to customers that he would take the customers off of margin, but he failed too do so. In October 2003 and June 2004, in Boca Raton, Florida, Caprioo represented to customers that he would use margin only modestly.

- **Gagliardi**. Between 2004 and 2007, through telephone calls that occurred ino New York and Florida, Gagliardi represented to a customer that using margino to purchase Program CMOs was safe and posed no risk.o
- **Kautz**. In September 2005, in Medford, Oregon, Kautz represented to ao customer that margin would only be used temporarily. In June and July 2006,o Kautz led two other customers to open margin accounts, but did not explaino the risks of using margin with Program CMOs.o
- **Kornfeld**. Between 2003 and 2007, in Coral Springs, Florida, Kornfeldo invested customers' funds on margin without their knowledge and withouto disclosing the risks of using margin to purchase Program CMOs.o
- **McCann**. In June 2005 and March 2007, McCann recommended thato customers purchase Program CMOs on margin because as a way to increaseo income. McCann failed to disclose the risks of using margin to purchaseo Program CMOs.o
- **Popper**. In 2003, in Boca Raton, Florida, Popper requested that a customero invest in Program CMOs using margin, representing that he would only useo margin modestly and that using margin to invest in Program CMOs waso nothing to worry about. In 2000, in Boca Raton, Florida, Popper representedo to a customer that he would use margin modestly (defined as less than 1% ofo her account equity) to invest in Program CMOs, and that the customer'so principal would remain safe.o
- **Rubin**. Between 2003 and 2007, in Coral Springs, Florida, Rubin investedo customers' funds on margin without their knowledge and without disclosingo the risks of using margin to purchase Program CMOs.o
- **Shrago**. In November 2003, in St. Petersburg, Florida, Shrago asked ao customer to complete a margin application but failed to explain the riskso associated with margin and led the customer to believe that the use of margino would not jeopardize her principal. Shrago also continued to leverage thiso

customer's account after being instructed to take the account off of margin. In fact, from at least 2004 to 2007, Defendants heavily margined their CMO Program customers' margin accounts, which were concentrated in IOs, Inverse Floaters, and Inverse IOs, and this use of margin exposed the customers to the risk of a substantial or total loss of equity.

47.e Betta, Gagliardi, and Popper additionally misrepresented that the use of margine was risk-free because Program CMOs were backed by the United States government. For example, in December 2003, Betta, Gagliardi, and Popper represented to a customer that Program CMOs had no chance of a margin call because they were "government bonds" with "zero risk to principal." Between 2004 and 2007, Gagliardi represented to other customers that investing in Program CMOs on margin was safe because they were government backed. In fact, even government-backed Program CMOs could suffer price drops, which could and did lead to margin calls. Moreover, no guarantee protected customers from the expiration of an IO.

E. **Falling CMO Prices Lead to Margin Calls**

48.e In early 2007, MBS and CMO prices began to drop in apparent response to thee failure of several large subprime mortgage lenders. As a result of declining CMO prices, all CMO Program customers saw the value of their accounts decline, and many CMO Program customers who had invested on margin started to receive margin calls.

49.e Due the level of margin that Defendants had used, some CMO Program customerse did not have sufficient equity to cover the margin calls. Under its margin agreement with its clearing firm, Brookstreet was financially responsible for margin calls that its customers could not cover.

50.e In June 2007, Brookstreet and its clearing firm liquidated many CMO Programe customers' accounts, resulting in millions of dollars in losses. Approximately eighty of Defendants' CMO Program customer accounts were left with "deficit accounts" of approximately $36 million. The accounts not only lost all principal, but ended up with negative equity such that the account owners owed the clearing firm approximately $36 million. Total losses for all of Defendants' CMO Program customers greatly exceeded that amount.

51. On June 21, 2007, the massive deficits in CMO Program customers' margin accounts caused Brookstreet to fall below its net capital requirements and terminate operations.

FIRST CLAIM FOR RELIEF

Fraud in Violation of Section 17(a) of the Securities Act

52.e The Commission realleges and incorporates by reference paragraphs 1 through 51e above.

53.e Defendants, knowingly or recklessly, in the offer or sale of securities, by use ofe means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly: (a) obtained money or property by means of untrue statements of material facts and omissions to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; and/or (b) engaged in transactions, practices and courses of business which operated or would operate as a fraud or deceit upon purchasers and prospective purchasers of such securities.

54.e Defendants' scheme included, among others, the fraudulent devices, fraudulente acts, untrue statements of material fact and material omissions described in paragraphs 20 through 47 above.

55. By engaging in the conduct described above, Defendants violated, and unlesse restrained and enjoined will continue to violate, Section 17(a) of the Securities Act, 15 U.S.C. §e77q(a).e

SECOND CLAIM FOR RELIEF

Fraud in Violation of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

56.e The Commission realleges and incorporates by reference paragraphs 1 through 55 above.

57.e Defendants, by engaging in the conduct described above, directly or indirectly, ine connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter: (a) employed devices, schemes, or artifices to defraud; (b) made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made,

in light of the circumstances under which they were made, not misleading; and/or (c) engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

58.e Defendants' scheme included, among others, the fraudulent devices, fraudulente acts, untrue statements of material fact and material omissions described in paragraphs 20 through 47 above.

59.e By engaging in the conduct described above, Defendants violated, and unlesse restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act, 15 U.S.C. §e78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

RELIEF REQUESTED

WHEREFORE, the Commission respectfully requests that the Court:

I.

Declare, determine, and find that Defendants committed the violations of the federal securities laws alleged in this Complaint.

II.

Issue a Permanent Injunction restraining and enjoining Defendants, and those persons in active concert or participation with them who receive actual notice of the judgment by personal service or otherwise, from violating Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

III.

Issue an Order requiring Defendants to provide a full accounting for, and disgorge all ill-gotten gains that they received, directly or indirectly, from, their illegal conduct, with prejudgment interest thereon.

IV.

Issue an Order requiring Defendants to pay civil money penalties pursuant to Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d) of the Exchange Act, 15 U.S.C. §e78u(d).e

V.

Issue an Order requiring Defendants to preserve any records related to the subject matter of this lawsuit that are in their custody or possession or subject to their control.

VI.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of the Court.

VII.

Grant such other and further relief as the Court may determine to be just and necessary.

Respectfully submitted:

DATED: May 28, 2009
Los Angeles, CA

RABIA A. CEBECI (A5501308)
cebecir@sec.gov
DOHOANG T. DUONG (A5501309)
duongdo@sec.gov
MORGAN B. WARD DORAN (A5501310)
warddoranm@sec.gov
MOLLY A. WHITE (A5501311)
whitem@sec.gov
Securities and Exchange Commission
5670 Wilshire Boulevard, 11th Floor
Los Angeles, CA 90036-3648
Phone: 323.965.3998
Fax: 323.965.3812
Attorneys for Plaintiff

Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served by hand delivery on May 28, 2009 on all counsel or parties of record on the attached service list.

Morgan B. Ward Doran

SERVICE LIST

SEC v. WILLIAM BETTA, JR., ET AL
United States District Court - Southern District of Florida
Case No.

Defendant	Party Served
William Betta, Jr.	William Betta, Jr. [redacted] Boca Raton, FL [redacted]
Travis A. Branch	Gary Victor Dubin Dubin Law Offices 55 Merchant Street Suite 3100, Harbor Court Honolulu, HI 96813 Phone: 808.537.2300 Fax: 808.523.7733 gdubin@dubinlaw.net
James J. Caprio	Robert Keddie, III Taylor, Colicchio, & Silverman, LLC 502 Carnegie Center, Suite 103 Princeton, NJ 08540 Phone: 609.987.0022 Fax: 609.987.0070 rkeddie@tcslawyers.com
Troy L. Gagliardi	Troy L. Gagliardi [redacted] Boca Raton, FL [redacted]
Russell M. Kautz	H. Thomas Fehn Fields Fehn & Sherwin 11755 Wilshire Blvd 15th Fl Los Angeles, CA 90025-1521 Phone: 310.473.6338 Fax: 310.473.8508 TomFehn@FFandslaw.com

Defendant	Party Served
Barry M. Kornfeld	James Sallah Sallah & Cox, LLC 2101 NW Corporate Blvd. Boca Raton, FL 33431 Phone: 561.989.9080 Fax: 561.989.9020 jds@sallahcox.com
Shane A. McCann	Michael A. Piazza Dorsey & Whitney 38 Technology Drive; Suite 100 Irvine, California 92618-5310 Phone: 949.932.3614 Fax: 949.271.5578 piazza.mike@dorsey.com
Clifford A. Popper	Clifford A. Popper [redacted] Miami Beach, FL [redacted]
Alfred B. Rubin	Alfred B. Rubin [redacted] Pompano Beach, FL [redacted]
Steven I. Shrago	Dan Newman Broad & Cassel One Biscayne Tower, 21st Floor 2 South Biscayne Blvd. Miami, FL 33131 Phone: 305.373.9467 Fax: 305.373.9443 dnewman@broadandcassel.com

JS 44 (Rev. 2/08)

CIVIL COVER SHEET

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON THE REVERSE OF THE FORM.) **NOTICE: Attorneys MUST Indicate All Re-filed Cases Below.**

I. (a) PLAINTIFFS

U.S. SECURITES AND EXCHANGE COMMISSION

(b) County of Residence of First Listed Plaintiff _____ (EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorney's (Firm Name, Address, and Telephone Number)

Morgan B. Ward Doran (323.965.3230) Molly A. White (323.965.3250)
5670 Wilshire Blvd., 11th Floor
Los Angeles, CA 90036

DEFENDANTS

WILLIAM BETTA, JR., ET AL. (see attachment)

County of Residence of First Listed Defendant Palm Beach County (IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE TRACT LAND INVOLVED.

Attorneys (If Known)

(see attachment)

(d) Check County Where Action Arose: ☐ MIAMI-DADE ☐ MONROE ☐ BROWARD ☑ PALM BEACH ☐ MARTIN ☐ ST. LUCIE ☐ INDIAN RIVER ☐ OKEECHOBEE ☐ HIGHLANDS

II. BASIS OF JURISDICTION (Place an "X" in One Box Only)

☑ 1 U.S. Government Plaintiff
☐ 3 Federal Question (U.S. Government Not a Party)
☐ 2 U.S. Government Defendant
☐ 4 Diversity (Indicate Citizenship of Parties in Item III)

09CV 80803 KAM/LRS

III. CITIZENSHIP OF PRINCIPAL PARTIES (Place an "X" in One Box for Plaintiff and One Box for Defendant) (For Diversity Cases Only)

	PTF	DEF		PTF	DEF
Citizen of This State	☐ 1	☐ 1	Incorporated or Principal Place of Business In This State	☐ 4	☐ 4
Citizen of Another State	☐ 2	☐ 2	Incorporated and Principal Place of Business In Another State	☐ 5	☐ 5
Citizen or Subject of a Foreign Country	☐ 3	☐ 3	Foreign Nation	☐ 6	☐ 6

IV. NATURE OF SUIT (Place an "X" in One Box Only)

CONTRACT	TORTS		FORFEITURE/PENALTY	BANKRUPTCY	OTHER STATUTES
☐ 110 Insurance	PERSONAL INJURY	PERSONAL INJURY	☐ 610 Agriculture	☐ 422 Appeal 28 USC 158	☐ 400 State Reapportionment
☐ 120 Marine	☐ 310 Airplane	☐ 362 Personal Injury - Med. Malpractice	☐ 620 Other Food & Drug	☐ 423 Withdrawal 28 USC 157	☐ 410 Antitrust
☐ 130 Miller Act	☐ 315 Airplane Product Liability	☐ 365 Personal Injury - Product Liability	☐ 625 Drug Related Seizure of Property 21 USC 881	PROPERTY RIGHTS	☐ 430 Banks and Banking
☐ 140 Negotiable Instrument	☐ 320 Assault, Libel & Slander	☐ 368 Asbestos Personal Injury Product Liability	☐ 630 Liquor Laws	☐ 820 Copyrights	☐ 450 Commerce
☐ 150 Recovery of Overpayment & Enforcement of Judgment	☐ 330 Federal Employers' Liability	PERSONAL PROPERTY	☐ 640 R.R. & Truck	☐ 830 Patent	☐ 460 Deportation
☐ 151 Medicare Act	☐ 340 Marine	☐ 370 Other Fraud	☐ 650 Airline Regs.	☐ 840 Trademark	☐ 470 Racketeer Influenced and Corrupt Organizations
☐ 152 Recovery of Defaulted Student Loans (Excl. Veterans)	☐ 345 Marine Product Liability	☐ 371 Truth in Lending	☐ 660 Occupational Safety/Health		☐ 480 Consumer Credit
☐ 153 Recovery of Overpayment of Veteran's Benefits	☐ 350 Motor Vehicle	☐ 380 Other Personal Property Damage	☐ 690 Other		☐ 490 Cable/Sat TV
☐ 160 Stockholders' Suits	☐ 355 Motor Vehicle Product Liability	☐ 385 Property Damage Product Liability	LABOR	SOCIAL SECURITY	☐ 810 Selective Service
☐ 190 Other Contract	☐ 360 Other Personal Injury		☐ 710 Fair Labor Standards Act	☐ 861 HIA (1395ff)	☒ 850 Securities/Commodities/ Exchange
☐ 195 Contract Product Liability			☐ 720 Labor/Mgmt. Relations	☐ 862 Black Lung (923)	☐ 875 Customer Challenge 12 USC 3410
☐ 196 Franchise			☐ 730 Labor/Mgmt.Reporting & Disclosure Act	☐ 863 DIWC/DIWW (405(g))	☐ 890 Other Statutory Actions
REAL PROPERTY	CIVIL RIGHTS	PRISONER PETITIONS	☐ 740 Railway Labor Act	☐ 864 SSID Title XVI	☐ 891 Agricultural Acts
☐ 210 Land Condemnation	☐ 441 Voting	☐ 510 Motions to Vacate Sentence	☐ 790 Other Labor Litigation	☐ 865 RSI (405(g))	☐ 892 Economic Stabilization Act
☐ 220 Foreclosure	☐ 442 Employment	Habeas Corpus:	☐ 791 Empl. Ret. Inc. Security Act	FEDERAL TAX SUITS	☐ 893 Environmental Matters
☐ 230 Rent Lease & Ejectment	☐ 443 Housing/ Accommodations	☐ 530 General		☐ 870 Taxes (U.S. Plaintiff or Defendant)	☐ 894 Energy Allocation Act
☐ 240 Torts to Land	☐ 444 Welfare	☐ 535 Death Penalty	IMMIGRATION	☐ 871 IRS—Third Party 26 USC 7609	☐ 895 Freedom of Information Act
☐ 245 Tort Product Liability	☐ 445 Amer. w/Disabilities - Employment	☐ 540 Mandamus & Other	☐ 462 Naturalization Application		☐ 900 Appeal of Fee Determination Under Equal Access to Justice
☐ 290 All Other Real Property	☐ 446 Amer. w/Disabilities - Other	☐ 550 Civil Rights	☐ 463 Habeas Corpus-Alien Detainee		
	☐ 440 Other Civil Rights	☐ 555 Prison Condition	☐ 465 Other Immigration Actions		☐ 950 Constitutionality of State Statutes

V. ORIGIN (Place an "X" in One Box Only)

☑ 1 Original Proceeding ☐ 2 Removed from State Court ☐ 3 Re-filed- (see VI below) ☐ 4 Reinstated or Reopened ☐ 5 Transferred from another district (specify) ☐ 6 Multidistrict Litigation ☐ 7 Appeal to District Judge from Magistrate Judgment

VI. RELATED/RE-FILED CASE(S). (See instructions second page): a) Re-filed Case ☐ YES ☑ NO b) Related Cases ☐ YES ☑ NO

JUDGE _____ DOCKET NUMBER _____

VII. CAUSE OF ACTION Cite the U.S. Civil Statute under which you are filing and Write a Brief Statement of Cause (**Do not cite jurisdictional statutes unless diversity**):

15 U.S.C. § 78j(b), 15 U.S.C. § 77q(a): Fraud in the offer, purchase, or sale of securities.

LENGTH OF TRIAL via 14 days estimated (for both sides to try entire case)

VIII. REQUESTED IN COMPLAINT: ☐ CHECK IF THIS IS A CLASS ACTION UNDER F.R.C.P. 23 **DEMAND $** CHECK YES only if demanded in complaint: **JURY DEMAND:** ☐ Yes ☑ No

ABOVE INFORMATION IS TRUE & CORRECT TO THE BEST OF MY KNOWLEDGE SIGNATURE OF ATTORNEY OF RECORD DATE May 28, 2009

FOR OFFICE USE ONLY

AMOUNT _____ RECEIPT # WAIVED IFP _____

Defendant	Attorney
William Betta, Jr. [redacted] Boca Raton, FL [redacted]	N/A
Travis A. Branch [redacted] Kaneohe, HI [redacted]	Gary Victor Dubin Dubin Law Offices 55 Merchant Street Suite 3100, Harbor Court Honolulu, HI 96813 Phone: 808.537.2300 Fax: 808.523.7733 gdubin@dubinlaw.net
James J. Caprio [redacted] Weston , FL [redacted]	Robert Keddie, III Taylor, Colicchio, & Silverman, LLC 502 Carnegie Center, Suite 103 Princeton, NJ 08540 Phone: 609.987.0022 Fax: 609.987.0070 rkeddie@tcslawyers.com
Troy L. Gagliardi [redacted] Boca Raton, FL [redacted] Cell: [redacted]	N/A
Russell M. Kautz 106 Oregon Terrace Medford, OR 97504	H. Thomas Fehn Fields Fehn & Sherwin 11755 Wilshire Blvd 15th Fl Los Angeles, CA 90025-1521 Phone: 310.473.6338 Fax: 310.473.8508 TomFehn@FFandslaw.com
Barry M. Kornfeld [redacted] Parkland, FL [redacted]	James Sallah Sallah & Cox, LLC 2101 NW Corporate Blvd. Boca Raton, FL 33431 Phone: 561.989.9080 Fax: 561.989.9020 jds@sallahcox.com

Defendant	Attorney
Shane A. McCann [redacted] Florence, MT [redacted]	Michael A. Piazza Dorsey & Whitney 38 Technology Drive; Suite 100 Irvine, California 92618-5310 Phone: 949.932.3614 Fax: 949.271.5578 piazza.mike@dorsey.com
Clifford A. Popper [redacted] Miami Beach, FL [redacted] [redacted] Highland Beach, FL [redacted]	N/A
Alfred B. Rubin [redacted] Pompano Beach, FL [redacted]	Howard S. Dargan Howard S. Dargan, PA 13833 Wellington Trace, Suite E4-119 West Palm Beach, FL 33414 Phone: 561.795.5311 Fax: 561.792.4397 howarddarganlaw@aol.com
Steven I. Shrago [redacted] St Petersburg, FL [redacted]	Dan Newman Broad & Cassel One Biscayne Tower, 21st Floor 2 South Biscayne Blvd. Miami, FL 33131 Phone: 305.373.9467 Fax: 305.373.9443 dnewman@broadandcassel.com

EXHIBIT 3

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 09-80803-CIV-MARRA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

WILLIAM BETTA, JR., TRAVIS A. BRANCH, JAMES J. CAPRIO, TROY L. GAGLIARDI, RUSSELL M. KAUTZ, BARRY M. KORNFELD, SHANE A. MCCANN, CLIFFORD A. POPPER, ALFRED B. RUBIN, and STEVEN I. SHRAGO,

Defendants.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

THIS CAUSE came before the undersigned United States District Judge for a non-jury trial. The trial lasted approximately four weeks. Based upon the evidence and testimony submitted, and considering the relevant statutory provisions and case law, this Court finds in favor of Troy L. Gagliardi, Russell M. Kautz, Shane A. McCann, Alfred B. Rubin and Steven I. Shrago and against the Commission as to these five defendants. The Commission is not entitled to injunctive relief against these five defendants, the Court will not order disgorgement of commissions earned by these five defendants, and no civil penalties will be levied. As to defendants William Betta, Jr. and Travis A. Branch, the Court finds the Commission has proven by a preponderance of the evidence that William Betta, Jr. and Travis A. Branch violated the securities laws. The penalties imposed against William Betta, Jr. and Travis A. Branch is discussed at the end of this Order. A final judgment to this effect shall be entered by separate

order. Pursuant to the requirements of Federal Rule of Civil Procedure 52, the following findings of fact and conclusions of law are hereby issued.

INTRODUCTION

The Securities and Exchange Commission ("Commission") filed a complaint for injunctive[1] and other relief against William Betta, Jr. ("Betta"), Travis A. Branch ("Branch"), Troy L. Gagliardi ("Gagliardi"), Russell M. Kautz ("Kautz"), Shane A. McCann ("McCann"), Clifford A. Popper ("Popper"), Alfred B. Rubin ("Rubin"), and Steven I. Shrago ("Shrago") (collectively "Defendants"),[2] all former registered representatives of Brookstreet Securities Corp. ("Brookstreet"), a now-defunct broker-dealer. The Complaint asserts two causes of action against Defendants: (1) violations of Section 17(a)[3] of the Securities Act of 1933 ("Securities Act") (Count I); and (2) violations of Section 10(b) and Rule 10b-5 of the Securities Exchange Act ("Exchange Act") (Count II). The Commission alleges that between 2004 and 2007, false and misleading statements in connection with the offer, sale, or purchase of certain risky types of Collateralized Mortgage Obligations ("CMOs") were made.[4]

The Commission seeks a judgment from the Court (a) enjoining Defendants from engaging, directly or indirectly, in further violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (b) ordering Defendants to

---

[1] The Commission seeks to restrain and permanently enjoin all defendants from violating the anti-fraud provisions of the federal securities laws. Complaint ("Compl"), DE 1, ¶ 1.

[2] Defendants James Caprio and Barry Kornfeld entered into consent judgments. *See* DE 53 and 115.

[3] The Complaint does not differentiate between §§ 17(a)(1), 17(a)(2), and 17(a)(3), however, it is apparent from the Complaint's context that the Commission is moving solely under § 17(a)(1), as it argues that Defendants knowingly or severely recklessly violated the law. There is no negligence alleged. Compl. ¶¶ 43, 44, 45, 53.

[4] There are many different types of CMOs, each with its own yield, price volatility, and risk characteristics. Some CMOs are relatively benign. Brookstreet, however, almost exclusively traded three types of CMOs that were particularly risky. These three types of CMOs, collectively referred to as "Program CMOs," accounted for about 94% of the trades in Brookstreet's CMO Program Accounts. Trial Transcript ("TT") at 518-519, 530-537, 912. Other references to the trial transcript may also be made by citing the docket number ("DE") in the Court file.

disgorge, with prejudgment interest, the amount by which they were unjustly enriched as a result of their violations of the federal securities laws; and (c) ordering Defendants to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).[5]

Previously the Commission moved for summary judgment as to three of the eight Defendants. In denying those motions, the Court concluded that the Commission had not adduced sufficient evidence to satisfy the scienter requirement of severe recklessness. *See* Orders and Opinions at DE nos. 216 (Gagliardi); 217 (Shrago); and 218 (Branch). The Court concluded that, at most, the Commission established that some of Defendants' recommendations were not appropriate or reasonable, but the Commission clearly fell short of demonstrating intent or severe recklessness. The Court also found that plausible, opposing inferences could be made from the evidence which precluded the conclusion that Defendants either knew, or it was so obvious that they must have known, that Program CMOs were inappropriately risky for investors who had preservation of capital as their main objective.[6]

FINDINGS OF FACT

A. BROOKSTREET

1. Brookstreet was a California corporation headquartered in Irvine, California, and was a registered broker-dealer and investment adviser.[7] Brookstreet's headquarters was where Brookstreet's management and compliance and legal department were located. Brookstreet

[5] Compl. ¶ 6.
[6] DE 216, 217, 218.
[7] Pretrial Stipulation ("PTS") (DE 232 at 2 of 62).

had an in-house compliance department in Irvine that supported the representatives throughout the firm, as well as outside legal counsel also located in California.[8]

2. Brookstreet's President and founder was Stanley Brooks ("Brooks").[9]

[8] TT at 2997-98; Rubin Ex. 10a.

[9] The Court takes judicial notice of the following: The Commission filed a separate action in the Central District of California against Brooks and Brookstreet seeking a permanent injunction and disgorgement. *See* DE 60 in case no. 8:09-cv-01431-DOC-AN. The District Court in California granted the Commission's motion for summary judgment against both defendants, in part, because it accepted *all* (emphasis in original) the Commission's undisputed statement of facts because the defendants had not adequately produced evidence or cited to the record to contradict any specific fact. *Id.* at 2. In fact, the defendants failed to file any response until after the District Court granted the motion for summary judgment and entered final judgment against them. The prohibitively late response, deemed wholly inadequate (which the District Court characterized as a "charade" and "rife with . . . chicanery"), was addressed in an "Order Reconsidering Prior Order, But Once Again Granting Plaintiff's Motion for Summary Judgment" ("Order"). *Id.*

In the Order, the District Court in California found Brookstreet and Brooks were controlling persons over the registered representatives "as a matter of law." *Id.* at 14. It further held that

> Brooks' prior testimony establishes that Brooks acted with recklessness by hiring and continuing to employ the CMO trader, Popper, over the objections of two vice presidents and despite Popper's blemished employment record... Moreover, Brooks continued to facilitate the CMO Program and promote it to Brookstreet's registered representatives, despite repeated warnings that the CMOs were a "toxic" investment... The likelihood that Brooks lacked scienter is further belied by the undisputed fact that Brooks is [a] recidivist who was sanctioned by regulators 10 times between 1992 and 2007.

Id. at 16. The Ninth Circuit Court of Appeals added:

> Brooks was the CEO, President, Chairman of the Board, and owner of Brookstreet through his family trust. Moreover, before his FINRA suspension, Brooks was "involved in the nuts and bolts of how things worked," and "was involved in the minutiae" of the firm's practices. Brooks was also specifically involved in the CMO Program. Brooks' position as an officer, his involvement in the day-to-day affairs of Brookstreet, and his involvement in the CMO Program establish that he controlled the primary violators... Brooks knew that Brookstreet representatives were recommending and selling CMOs to retail customers beginning in 2004, and yet Brookstreet did not establish suitability standards for CMO clients until 2007, three years later. This failure is particularly egregious in light of Brooks' receipt of NASD Notice 95-73 in mid-2005, which detailed a broker's responsibility to educate clients about the risks of CMOs and made clear that certain CMOs were suitable only for sophisticated investors with a high risk profile. Brooks thus cannot show that Brookstreet's supervisory system was adequate and that it reasonably discharged its responsibilities under the system.

Case No. 12-56404, DE 41-1.

The District Court in California likewise found that Branch, Gagliardi, and Shrago had made material misrepresentations to their customers, including that CMOs were: safe for retirement accounts, comprised exclusively of government-backed bonds, would preserve principal, were liquid investments, and they omitted the fact that the relatively small size of the customers' CMO positions would make them difficult to sell. The District Court in California found Branch's scienter was shown by, among other things, his admission that he knew the CMO Program primarily traded risky securities yet he told investors that Program CMOs were backed by the federal government. DE 60 at 10. Gagliardi's and Shrago's scienter was shown through their recommending the CMO Program to customers despite having no prior experience with Program CMOs, not investigating them, and receiving e-mails stating that the CMOs were not suitable for their customers. *Id.* As stated above, these conclusions were taken directly from the Commission's statement of undisputed facts, without any proper defense being made. In the instant case, this Court has had the benefit of carefully reviewing disputed motions for summary judgment and a full trial on the merits, permitting assessments of credibility and weighing of evidence.

3. Brookstreet employed 750 registered representatives in approximately 300 offices located throughout the United States. About 40 or 50 brokers were involved with the CMO Program, managing approximately 1,000 accounts.[10]

4. Brookstreet was a member of NASD from at least January 1, 2004 until June 1, 2007.[11]

5. In 1993, the NASD issued Notice to Members 93-73: Member's Obligations to Customers When Selling Collateralized Mortgage Obligations ("NASD Notice 93-73"). The suggested routing for this Notice was "Senior Management[,] Government Securities[,] Legal & Compliance." The Notice, addressing individual CMOs, not a managed program containing several different CMOs, states that Inverse Floaters and Interest Only securities are only suitable for sophisticated investors with a high-risk profile. http://finra.complinet.com/ This Notice was not shared with Brookstreet's brokers.[12]

6. Between 2004 and 2007, Brookstreet invested clients' funds in risky types of CMOs that were not all guaranteed by the United States government and were only suitable for sophisticated investors with a high-risk investment profile. These risky CMOs were sold to some clients who were relatively unsophisticated and had a conservative, rather than a high-risk, profile.

7. Moreover, Brookstreet and its clearing firm, National Financial Services ("NFS") (a/k/a Fidelity), allowed, and even encouraged, retail customers to utilize margin to purchase

[10] DE 355 at 159, 167.
[11] PTS ¶ 2 (DE 232 at 25 of 62).
[12] TT at 1568-1569, 2305, 2306; 2310.

CMOs.[13] In essence, money was loaned from Brookstreet's clearing firm to clients in order to buy these volatile and risky securities.[14]

8. Each customer participating in Brookstreet's CMO Program who utilized margin supplied by NFS executed a margin account application and agreement with NFS.[15]

9. Margin magnifies the effect gains or losses in a security's value have on the equity in an account.[16] A drop in value of a CMO can trigger a margin call if the client does not have enough equity in their account to support the loan.[17] Margin exposes investors to the possibility of not only losing their entire investment, but also owing NFS money.[18] The Commission's expert opined that margining Program CMOs is particularly dangerous because of the high degree of financial leverage already built-in the investment.[19] *Brookstreet representatives, however, were convinced by the CMO Program Manager that having a margin account for Program CMOs would give a client's account the necessary flexibility to maximize profits.*[20]

10. Beginning in early 2007, the CMO market began to fail, resulting in significant losses for Brookstreet's clients and margin calls for those clients on margin.[21] By June 2007, the margin calls had snowballed to the point where Brookstreet failed to meet its net capital

[13] PTS ¶¶ 22, 23 (DE 232 at 2 of 62); TT at 869; 872-874; 916; 2996; Trial Exs. 2, 64, 77, 161, 229.
[14] TT at 869.
[15] PTS ¶ 21 (DE 232 at 27 of 62).
[16] TT at 869-870, 908.
[17] TT at 870.
[18] TT at 870-871, 872.
[19] TT at 514-515, 521-522, 872-874, 907-908
[20] TT at 1666, 2851.
[21] TT at 108, 1308-1309, 1690, 1991, 2340-2341, 2616-2617; Fernandez Depo. at 141-142 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix B); Trial Exs. 12, 64, 77, 161, 229, 481.

requirements, causing the company to cease operations.[22] Many of Brookstreet's CMO clients lost their investments and their ability to retire or stay retired.[23]

B. Popper and the CMO Program

11. Popper brought the CMO Program to Brookstreet in 2004. Popper managed and directed the daily operations and trading activities of the "Institutional Bond Group," which was located in Brookstreet's Boca Raton office.[24] The Institutional Bond Group ran the CMO Program.[25]

12. Defendants Popper and Betta were part of the Institutional Bond Group. Defendants Gagliardi, Branch, Kautz, McCann, Rubin, and Shrago participated in the CMO Program.[26] Defendants each received commissions on CMO transactions relating to their CMO Program clients, although other Brookstreet investment products generated higher commissions.[27]

13. Popper had an extensive background in trading CMOs and positioned himself as the Portfolio Manager and head trader of the CMO Program.[28] He presented himself in a professional and confident manner and styled himself an expert in the field of CMOs - one who was able to reposition the portfolios he managed to react quickly and take advantage of changing interest rate environments.[29] This job was extremely lucrative for Popper. From 2004 through 2007, Popper made more than $18 million in commissions from CMO trading.[30]

---

[22] PTS ¶ 26 (DE 232 at 27 of 62).
[23] TT at 108, 338, 1353, 1694.
[24] PTS ¶ 8 (DE 232 at 26 of 62).
[25] PTS ¶ 9 (DE 232 at 26 of 62).
[26] PTS ¶¶ 8-10, 35, 38-39, 45-51, 66 (DE 232 at 26, 28-30 of 62).
[27] PTS ¶ 27 (DE 232 at 27 of 62).
[28] TT at 1173, 1188.
[29] TT at 70, 706, 798, 3002; Trial Ex. 305; TROY 03356-03360.
[30] TT at 506-507, 1229-1230; Popper Inv. Test. at 50.

C. PROGRAM CMOs[31]

14. A CMO is a security that is collateralized by mortgage-backed securities which in turn are undivided interests in a pool of mortgages.[32] CMOs issued by Ginnie Mae, Fannie Mae, or Freddie Mac are referred to as "agency" CMOs.

15. Brookstreet primarily sold three types of CMOs that are particularly risky and sensitive to changes in interest rates: Inverse Floating Rate CMOs ("Inverse Floaters"); Interest Only CMOs ("IOs"); and Inverse Interest Only CMOs ("Inverse IOs").[33] About 95% of the CMOs that Brookstreet traded from 2004 through 2007 were Program CMOs.[34]

16. The Commission's expert testified that Program CMOs are among the riskiest types of CMOs because the holders of these instruments are exposed to very high levels of interest-rate risk, price risk, and prepayment risk.[35] While the Commission's expert testified that Program CMOs were not suitable for retirees, risk adverse clients, or investors who wanted to protect their principal, the NASD's Advertising Regulation Department approved at least one educational presentation and one print advertisement for Program CMOs.

The educational presentation stated that the CMO Program "offers a managed portfolio for high net worth clientele comprised 100% of government agency bonds, Ginnie Mae, Fannie Mae and Freddie Mac," - a quality risk adverse investors would appreciate. However, the presentation also explained that the "relatively high coupon that the security offers when it is

[31] Because of the lengthy record and numerous substantive orders entered in this case, the Court assumes the readers' familiarity with Brookstreet's CMO Program, and therefore will engage in only a brief discussion of the factual and procedural background of same.
[32] PTS ¶ 3 (DE 232 at 25 of 62).
[33] TT at 518; 532; 534; 535-537.
[34] TT at 912.
[35] TT at 517, 535-537.

purchased reflects the risk that, in the life of the security, the market value and/or the coupon may substantially decrease."[36]

The advertisement, entitled "LOOKING FOR MONTHLY INCOME?", was run in local newspapers and appears to target, among others, retirees and risk adverse investors. The add stated:

> Proper diversification can help to smooth the bumps in your investment portfolio's performance. Consider adding high-quality fixed income securities, like Collateralized Mortgage Obligations (CMOs) to your investment mix. CMOs can provide: Attractive Yields, Monthly Cashflow, $1,000 Minimum Denomination, Implied AAA Credit Rating, Wide Variety of Available Structures, Portfolio Diversification.[37]

17. Sometime in 2005, the Institutional Bond Group started purchasing "non-agency" CMOs, which carried no government-related guarantee at all.[38] Non-agency CMOs then made up about 10% of the Program.[39] Up through at least 2006, Brookstreet misrepresented to its brokers and the world, that the CMO Program bought only government agency bonds, Ginnie Mae, Fannie Mae and Freddie Mac.[40]

18. Popper managed and directed the daily operations and trading activities of the Institutional Bond Group.[41] Popper selected each CMO that was purchased or sold within the CMO Program.[42] Popper purchased and sold the CMOs from and to traders at other institutions.[43]

---

[36] TT at 3045, 3047-3048, Rubin Ex. 37, 46, SEC Ex. 305.
[37] *Id.*
[38] DE 356 at 244-250.
[39] TT at 912-913, 917.
[40] E-mail from Russell Riccobono, Brookstreet's National Branch Compliance Manager, dated March 23, 2006. Rubin Ex 46 at Troy 3297-98; DE 355 at 106 (SEC Ex. 305 at Troy 3359); DE 355 at 112 (SEC Ex. 334 at 2). DE 356 at 99, 133.
[41] PTS ¶ 8 (DE 232 at 26 of 62).
[42] PTS ¶ 15 (DE 232 at 26 of 62).
[43] *Id.*

19. Even though Popper told Brookstreet brokers that the recommendations they received to purchase and sell different CMOs in their customer accounts came from him, it was in fact his assistants who made these recommendations based on a spreadsheet that showed how much cash was available in each account.[44] No one in the Institutional Bond Group, neither Popper, Betta, nor these trading assistants were privy to any client's investment objective.[45]

20. Popper typically purchased and sold institutional-sized blocks called "round lots."[46] After a CMO purchase, the Institutional Bond Group broke these round lots into smaller "odd lot" positions for distribution into clients' accounts.[47] Odd-lot quantities were more difficult to sell because there were fewer buyers willing to purchase them.[48]

21. Prior to a sale, the Institutional Bond Group would aggregate clients' odd lot CMO positions into round lots, which were more easily sold in the market.[49]

22. CMO Program clients sometimes requested that Defendants sell their CMO positions outside of Popper's standard sale process.[50] Some clients faced liquidity problems and complained of delays of up to seven months.[51] As a result, clients were either cross-traded with other CMO Program clients, or they had to wait until Popper decided to aggregate their CMOs with other clients' positions to sell a round lot to the market.[52] There was also a Brookstreet house account that would buy odd lots from customers.[53]

---

[44] DE 355 at 97-98, 149; DE 362 at 39.
[45] *Id.*
[46] PTS ¶ 16 (DE 232 at 26 of 62).
[47] PTS ¶ 17 (DE 232 at 26 of 62).
[48] TT at 897.
[49] PTS ¶ 17 (DE 232 at 26 of 62), TT at 519-521, 896-897.
[50] TT at 1009-1010, 101, 1607-1608, 1854.
[51] TT at 1417, 1418, 1421-1422, 1500-1502; Trial Exs. 146-47, 280, 330A; *see also*, Tumminello Depo. at 44-45 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix H).
[52] TT at 1009-1011, 1607-1608.
[53] TT at 1010-1011.

23. Popper knew that investing in Program CMOs was risky.[54] He testified at trial that there can be an inherent risk of loss of equity with Inverse Floaters if they are sold before maturity, yet he typically traded out Inverse Floaters before maturity.[55] Popper also knew that IOs were risky. At trial, Popper admitted that he knew that one of the risks associated with IOs was the risk of prepayment.[56] Popper knew that IOs were not suitable for investors with low risk profiles.[57] Popper also admitted that a portfolio containing IOs and Inverse Floaters would not be appropriate if an investor's only objective was capital preservation.[58]

24. Despite this knowledge, from January 2004 to June 2007, *and with the full support of Brookstreet*, Popper held seminars at Brookstreet's annual product marketing conferences, circulated internal e-mails, and held conference calls to solicit Brookstreet registered representatives, including Branch, Gagliardi, Kautz, McCann, Rubin, and Shrago, to recommend investments in a portfolio of different CMOs to their customers.[59]

---

[54] Indeed, when Popper testified in his own defense, he stated that he warned the registered representatives that Program CMOs were risky. According to Popper, he told brokers at Brookstreet's annual conferences, on conference calls, and in e-mails (TT at 1193, 1239-1240, 1254-1255) (1) that the type of investor appropriate for the CMO Program was a sophisticated investor with high net worth and a high risk tolerance (TT at 1194-1196); (2) that he never said the CMOs purchased in the Program would be government backed; (3) that he clearly identified the risks of the CMOs in the Program and discussed that the coupon and duration would change (TT at 1195); (4) that he made it absolutely clear that a clients' principal would be at risk (TT at 1195); (5) that he did not say that Program CMOs would be appropriate for clients with conservative investment objectives (TT at 1195-1196); and (6) that he did not use the phrase "government backed securities" to describe the CMOs he purchased, but instead told brokers that the CMOs he purchased from 2004 through 2007 included non-agency CMOs (TT 1196-1197, 1194). Popper's testimony is at complete odds with all the other evidence presented at trial and is found to be lacking in credibility and is rejected.

[55] TT at 1185-1186.

[56] TT at 1187.

[57] TT at 1209.

[58] TT at 1209-1210.

[59] PTS, ¶ 11 (DE 232 at 26 of 62).

25. Popper told brokers that the CMO Program was a portfolio of government backed bonds that produced good income,[60] that it was a good investment for retirees,[61] and that it would take a maximum of 90 days to redeem an account.[62]

26. Other misrepresentations Popper made include that: (1) the CMO Program could be tailored to fit a conservative investment portfolio and that the Program was suitable for clients with conservative investment objectives;[63] (2) investing on margin would lower the risk to clients because they would have a more diversified CMO portfolio;[64] (3) investing in the CMO Program was not risky because Popper had skill and expertise to successfully navigate the CMO market;[65] and (4) that IOs and Inverse Floaters could be used in conjunction with each other to achieve a high level of return concurrent with capital preservation.[66]

27. The value of Program CMOs was estimated by FT Interactive, a pricing service. From time to time, the pricing of certain CMOs was very volatile.[67] However, Brookstreet, Popper and his team continued to represent to the brokers that the models used by FT Interactive was not accurate, based on values from actual sales made by Popper.[68]

28. Likewise, from time to time, certain individual CMOs took longer to liquidate than the 90 days Popper had originally represented.[69] However, for the most part, Popper was able to

---

[60] TT at 3-14, 202-203, 2588.
[61] George Depo. at 35-36, 36, 37-38, 39-40 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix C);.
[62] TT at 2602.
[63] TT at 1665-1666, 2851; 1198-1199, 2597. In fact, Popper did not have access to customer investment objectives. DE 355 at 95-97, 163, 165; DE 362 at 51.
[64] TT at 1666, 2851.
[65] TT at 1666, 285.
[66] TT at 1666, 2851, Rubin Ex. 3.
[67] Rubin Ex. 31; SEC Ex. 279.
[68] TT at 729-30, 771-72, 1242, 1527-28, 2822-23, 2952-56, 2995, 3004, 3042-43, 3049-50; Rubin Ex. 31.
[69] SEC Ex. 280.

actively purchase and sell Program CMOs, until the collapse in the financial and housing markets in the spring 2007.[70]

29. Nonetheless, credible evidence was presented at trial that Brooks (and other top executive/compliance officers) had been advised by several of the firm's senior bond traders (including Andrew DePrimio) that the CMO Program was not suitable for any retail customers.

30. Moreover, they were advised that Popper was actively deceiving the firm's registered representatives. Notwithstanding this information, neither Brooks, nor any of the firm's senior executive/compliance officers, took steps to shut down the CMO Program, or to otherwise warn **any** of the firm's registered representatives about these troubling facts.[71]

31. Brooks and Popper (both directly and indirectly through members of the Institutional Bond Group) continued to reassure the firm's representatives that the CMO Program was sound and suitable for its customers, and that any pricing volatility and/or liquidity issues were only temporary occurrences.[72]

32. For example, in October 2005, clients and brokers were alarmed about the decreasing value of certain CMOs. Popper and the Institutional Bond Group repeatedly reassured representatives that the outside pricing model being utilized to estimate the market value was underestimating their true value. Popper cited specific examples of CMOs that were sold in the market for higher prices than had previously been reported as proof of the prior pricing error.[73] Brookstreet went so far as to have its legal and compliance department prepare a letter for the

[70] TT at 3197, 3209-11.
[71] TT at 202-204, 207-09, 215-16, 233, 659-60, 683-84, 3050-51.
[72] Alfred Rubin Exhibits ("AR-#"): AR-31, AR-38.
[73] TT at 3049-50.

representatives to distribute to their clients which explained these pricing issues to allay any concerns relating to the value of CMO Program bonds.[74]

33. Each Defendant testified that he did not knowingly or intentionally make any misrepresentation or omission of a material fact to an investor or prospective investor in the CMO program.

D. The Influence of Brookstreet's Legal and Compliance Department

34. Brookstreet's legal and compliance department supervised and instructed the representatives who participated in the CMO Program.[75] The representatives saw Brookstreet's compliance department employees at the various conferences and seminars where Popper conveyed information about the CMO Program, and they received compliance approved e-mails about Program CMOs. They were aware that the compliance department was in attendance on the conference calls, and they were aware of the CMO information on Brookstreet's website.[76,77] Brokers further understood the firm had hired both in-house legal counsel (Julie Mains), as well

[74] AR-39.

[75] TT at 656-57, 2996-98, 3026, 3045, 3047-49, 3059; AR- Ex. 9, 37, 46, 78-A; SEC Ex. 21, 73, 100, 169, 250, 299, 300, 301, 305, 306, 330-A, 341, 383, 384, 391, 502, 516, 521, 557, 563, 594-B, T-65, T-66, T-67.

[76] The representations on Brookstreet's website were entirely consistent with the various oral representations that brokers heard Popper (and his team) repeatedly make concerning Brookstreet's CMO program. These included, among other things, representations that:
1) "We can structure individual portfolios starting at $100,000 ... in a diversified and complementary portfolio of different issues with different profiles.";
2) "We can accommodate investors with conservative agendas as well as more aggressive objectives.";
3) "Our focus is total return, which is a combination of interest income and capital gains, consistent with capital preservation.";
4) "SFA [Strategic Financial Advisors, Inc. (a portfolio management service of Brookstreet)] utilizes an extensive network of Institutional contacts to purchase and sell multi-million dollar blocks of Government Agency Bonds and provides significant cost savings due to economies of scale for substantial individual investors.";
5) "Accounts are structured to perform under a wide variety of economic circumstances and interest rate environments."; and
6) "Through a long-standing relationship between our seasoned fixed income specialists and portfolio strategists combined with the dedicated service of our Financial Advisors, we provide high net worth investors with custom advice and expertise in critical areas which include: investing, portfolio management, monthly evaluations, real-time performance reporting, and hands on daily monitoring of client accounts." [AR- Ex. 11].

[77] Ex. G-9; TT at 1247-48, 1250-51, 1255; AR- Ex. 3, 11.

as an outside securities counsel (Tom Fehn), who attended the CMO Program break-out sessions.[78]

35. Representatives who participated in the CMO program considered Brookstreet's compliance department to be active in overseeing both the brokers and the clients.[79] They knew that before any new CMO account was opened, compliance reviewed the paperwork to make sure the investor met whatever minimum requirements were established at the time, and that no transactions could occur until an actual account was set up and reviewed by Brookstreet compliance.[80]

36. Defendants were aware of Brookstreet's policy that any public communications concerning the CMO program were required to be reviewed and formerly approved by the firm's legal and compliance department.[81] Some Defendants utilized two primary forms of approved advertising regarding the CMO Program: a one hour taped radio program, and a newspaper advertisement entitled "Looking for Monthly Income."[82] The taped radio program disclosed, among other things (1) the nature and types of CMOs that were being used in the program; (2) the fact that the value of the CMOs could go up or down, particularly if sold prior to maturity; and (3) that the CMOs were purchased in a block format but allocated to clients in smaller "odd lots" that were less liquid than the block.[83]

37. Defendants were aware that Brookstreet's legal and compliance department would send any proposed advertisements directly to the NASD for its review and approval before the ad

[78] TT at 2997-98; Rubin Ex. 10a.
[79] TT at 2296-97.
[80] TT at 656-57; 3026.
[81] TT at 3045, 3047-48.
[82] *Id.*
[83] TT at 3046-47; DE 355 at 113.

could be placed.[84] The overall form and content of these advertisements were consistent with the NASD's advertising rules and informative guidelines relating to "Communication with the Public About CMOs."[85] The NASD reviewed the proposed CMO advertising materials and often made corrective revisions to the proposed ad, which were then incorporated by Brookstreet compliance and resubmitted to NASD for further review, comment and eventually approval.[86]

E. Disclosures

38. It was not until February 2007, that Brookstreet started to take seriously the policies and procedures governing the sale of CMOs by its brokers. New procedures required, among other things, each Brookstreet representative who wanted to introduce clients to the CMO Program, or who already had clients in the Program, to complete a LaSalle Bond Institute course entitled "Mastering CMOs."

39. It was also required that each new CMO Program client had to be provided a copy of the "Investor's Guide to Collateralized Mortgage Obligations"[87] before placing any transactions with the CMO Bond Group, and acknowledge receipt of the guide in writing.[88]

40. Included with the CMO trade confirmations was an entire page called "Important CMO Information" as follows:

> CMOs entitle investors to payments of principal and interest, however they differ from CDs, corporate bonds, and Treasury securities in significant ways. CMOs are not issued with stated maturities and/or fixed interest rates, but in contrast, have stated final maturity dates at which all principal must be returned, however,

[84] TT at 3045, 3047-48; Rubin Ex. 37, 46; SEC Ex. 305.
[85] Rubin Ex. 37.
[86] TT at 3045, 3047-48; Rubin Ex. 37.
[87] The Commission's expert opined that the Investor's Guide to CMOs provides a competent general overview, and warns investors that there are risks not described in the brochure that the investor needs to discuss with his or her broker. It highlights areas of inquiry to discuss with the broker on page 20, and if the client does that, the expert opined, then he or she would adequately understand the risk involved. TT at 910.[87]
[88] T-67.

principal payments may be paid through the life of the security. In addition, the timing of these payments may vary significantly depending on interest rate changes.

Principal payments on CMOs arise from both the regular amortization of the underlying mortgages and from prepayments of those mortgages due to sales or refinancings. This activity can result in CMOs paying off principal more rapidly than had been anticipated, and the CMO investor may be faced with reinvesting his/her principal at a current lower rate. CMO investors may also face holding their investment for longer than anticipated if homeowners do not refinance or sell their houses as quickly. While principal payments may be predictable for certain tranches[89] of a given CMO, other tranches of the same issue may be significantly less predictable.

Certain tranches may be structured in such a manner that, depending on interest rates and prepayments, investors are at substantial risk and may lose all or a substantial portion of their principal. The risks associated with these less predictable tranches may make them unsuitable for many retail investors (emphasis added).

There is a sizable secondary market for CMOs generally, however, there is less of a market for the more risky and complex tranches. CMOs are less uniform than traditional mortgage-backed securities and more expensive to trade. It is also more difficult to obtain current pricing information. If an investor sells a CMO rather than waiting for the final principal payment, the security may be worth more or less than the original face value (emphasis added).

Any guarantees on the underlying securities in CMOs apply only to the par value of the security and not to any premium paid.

Additional Information on Inverse Floaters

Inverse floaters are structured to offset floating-rate tranches. Interest payments on Inverse Floaters vary inversely with an index. As Inverse Floaters are more leveraged than other tranches, they have high price volatility as interest rates move. As the rate of the index drops, the interest rate on the Inverse Floaters rise at an accelerated pace. Conversely, rising rates cause an Inverse Floater's interest payments to drop dramatically. At worst, rising rates will lower interest payments and extend return of principal beyond the anticipated average life. As with other high-risk tranches, Inverse Floaters are only suitable for sophisticated investors with a high-risk profile.

[89] A tranche is one of a number of related securities offered as part of the same transaction. An Investor's Guide to Collateralized Mortgage Obligations. Ex. 485.

> Additional Information on Interest-Only ("IO") Securities
> Interest-Only ("IO") Securities are one CMO type that sell at a deep discount to their "notional" principal amount, namely the principal balance used to calculate the amount of interest due. IO CMOs have no face or par value and, as the notional principal amortizes and prepays, the IO cash-flow will decline. IO investors should be mindful that if prepayment rates are high, they may actually receive less cash back than they initially invested.
>
> Margin Accounts
> Utilizing a margin loan for the purchase of CMOs could require an additional deposit (margin call) of funds and/or securities in the event of adverse market conditions. Failure to meet a margin call could result in a liquidation of the securities in the account in order to meet the call. In addition, the use of a margin loan will amplify the effects of an adverse market environment. Specifically with regard to margin investing in "Inverse-Floating Rate" CMOs, there is a potential for exacerbation of the inherent risk of loss of equity from investing in these securities as an increase in the market rate of interest would result in, not only a decline in their price which would necessitate a margin call, but also a potential rise in the level of interest being charged on any margin debit that is owed on the account.
>
> Investing in CMOs is by the instrument's nature **speculative**. If you are not comfortable with the aspects of these investments, please withdraw from these instruments immediately by calling your Brookstreet Member or the Brookstreet Client Services Desk at (888) 456-2578 for assistance.[90]

These disclosures in the 2007 CMO trade confirmations were too little, too late.

F. Investor Suitability for the CMO Program

41. Brookstreet's legal and compliance department was responsible for the policies of suitability and for the disclosure of risks associated with the CMO Program. When the CMO Program began in 2004, there was no formal written suitability requirements. *All that brokers were told is that to put someone into the CMO Program, they needed an income in excess of $25,000, and $100,000 in investable assets.*[91] The determination of customer suitability and the

[90] Gagliardi Ex. G-45, G-47 and G-48 (emphasis in originals, unless otherwise indicated).
[91] TT at 3009.

standard disclosures made to customers was monitored by the brokers' Series 24 supervisors and reviewed by the Brookstreet compliance department.

42. In 2005, brokers were told to provide investors with a copy of the Investor's Guide to Collateralized Mortgage Obligations brochure.[92]

43. In the summer of 2006, the income parameter was increased to above $50,000, plus a net worth in excess of $500,000.[93] Then the net worth requirement was raised to a million dollars (or an annual income of $200,000 for the past two years).[94]

44. In August 2006, Kyle Christensen ("Christensen"), Brookstreet's National Branch Compliance Manager, sent an e-mail to Brookstreet's registered representatives regarding CMO Program participant suitability.[95] Christensen stated that investors in the Program must now have a net worth of one million dollars, or a net worth of $500,000 with income of $50,000 or more, and the investor's investment objectives must be growth and income at a minimum, but speculation was preferred. "In other words, the objectives cannot be income or appreciation. Furthermore, the objective must be speculation if the account has margin."[96] Attached to the e-mail was a list of CMO Program investors that Brookstreet deemed unqualified per the new guidelines.[97] Representatives were directed to consult with their clients and either put the client on "sell only" status, or, if new information indicated they met the new guidelines, their financial profile or investment objectives were to be updated.[98]

---

[92] DE 356 at 197; T65, *see, supra,* note 8.
[93] TT at 3010.
[94] TT at 3011.
[95] SEC Ex. 73.
[96] *Id.*
[97] *Id.*; TT at 610-611; 3011.
[98] SEC Ex. 73.

45. In February of 2007, Brookstreet published a policy and procedure manual which included suitability guidelines for investors in the CMO Program.[99]

46. The Commission argues Christensen's e-mail should have put all Brookstreet brokers on notice that the CMO Program was not suitable for investors with conservative investment objectives such as income or appreciation.[100]

47. Many of the Defendants testified that once they received Christensen's e-mail, they spoke with their clients, went over the new suitability requirements, and the clients agreed to change their investment objectives and tolerance for risk, so they could remain in the Program.[101]

48. The brokers were given a 30-day deadline to obtain the updated client information, which was to be resubmitted to the home office for further review and approval.[102] Those clients who could be documented as having met Brookstreet's current suitability guidelines were permitted to remain in the CMO Program, while those who did not were supposed to be placed on "sell only" status.[103]

G. Oversight

49. Defendants knew that Brookstreet operated in a regulated industry and understood that the firm received extensive oversight and examination from the Commission, NASD/FINRA, as well as from the firm's own internal legal and compliance department.[104] These examinations were ongoing throughout the entire period of the CMO Program's existence.[105]

---

[99] AR- 9; SEC Ex. T-66.
[100] TT at 693-694; SEC Ex. 300.
[101] *See, e.g., infra* ¶¶ 101, 228, 255.
[102] *Id.;* TT at 684-87.
[103] *Id.*
[104] TT at 3059-61, 3191-92; AR- Ex. 6 (¶¶45-48); SEC Ex. 521.
[105] *Id.*

50. The compliance examinations conducted by the Commission and FINRA were extensive and covered virtually every aspect of Brookstreet's CMO Program including, among other things, reviewing the firm's policies and procedures, Program CMO customer new account opening applications, account statements, confirmations, disclosure materials, trade tickets, complaints, and advertising.[106] In connection with one such compliance examination at the Coral Springs branch office, compliance staff members from the Commission were onsite for more than three weeks reviewing the various records relating to the CMO Program.[107]

51. Defendants understood that no adverse findings or deficiency notices from the Commission or FINRA were ever issued to Brookstreet regarding any significant aspect of the CMO Program at the conclusion of any of these examinations.[108]

52. Some Defendants were aware that in 2004, the Commission conducted an investigation captioned, "In the Matter of Certain Sales of Mortgage-Backed Securities (HO-9844)" and that records concerning Brookstreet's CMO Program were produced, including but not limited to, account-opening paperwork, trade tickets, buy and sell confirmations, statements, e-mails, advertising, disclosure materials and correspondence.[109]

53. Defendants understood that the scope of the Commission's 2004 investigation was very broad and encompassed Brookstreet's entire CMO program.[110] Defendants were also aware that in the fall of 2004, Kornfeld and Popper appeared for lengthy testimony at the Commission's

---

[106] *Id.*
[107] TT at 3059-61.
[108] *Id.*; AR- Ex. 6 (¶48).
[109] TT at 2841, 3051-54, 3188-91, 3217-18.
[110] TT at 2841, 3051-54, 3188-91, 3217-18.

offices in Washington, D.C., and were asked detailed questions regarding virtually all aspects of the CMO Program.[111]

54. No formal or informal adverse action or deficiency notice whatsoever was issued regarding Brookstreet's CMO program.[112]

55. In addition, the Boca Raton branch office was audited by the compliance department at least once a year. The auditor looked at 10-20 random client files to make sure all documentation and correspondence was in order, and ensured that the brokers were familiar with the policies and procedures.[113] During these audits, no irregularities with respect to the CMO Program were reported.[114]

56. All of these events caused Defendants to believe that the CMO Program was fully vetted, not only by the Commission and FINRA, but by Brookstreet's most experienced staff, its executive management team, its legal and compliance department, as well as by the firm's outside counsel.[115] As a result of these, and the other facts mentioned above, Defendants believed that: (1) the CMO Program was being operated in compliance with all applicable federal securities laws, rules and regulations; (2) all of the firm's standardized CMO risk disclosures were appropriate; (3) Brookstreet's suitability guidelines were reasonable and appropriate and were being continually improved as time went on; and (4) the CMO Program was suitable for all of the Brookstreet's customers who were in it.[116]

---

[111] *Id.*
[112] TT at 2841, 3056-57, 3190-91; AR- Ex. 6 (¶48).
[113] DE 356 at 192-93.
[114] DE 356 at 193.
[115] TT at 2821-22, 2841, 2853-54, 3926, 3049, 3056-57, 3190-91.
[116] *Id.*

57. Defendants uniformly testified that they unequivocally believed what they were being told regarding the CMO Program, and in particular, that it was suitable for Brookstreet's retail clients. Defendants understood that the firm's compliance department was reviewing the account opening information to determine suitability for all new CMO accounts before the accounts were approved and opened at the home office. They further understood that the CMO Program was being closely monitored by the firm's compliance and legal department, and that it has also been thoroughly investigated by the Commission without incident, and has also passed multiple compliance examinations from 2004 through 2007 conducted by the Commission and FINRA examiners. As a result, many of the Defendants invested in the Program themselves and put their family members into the Program.

H. THE DEFENDANTS

Defendant Clifford A. Popper

58. Popper brought the CMO Program to Brookstreet in 2004, and was located at the Boca Raton office from January 2004 to June 2007.[117]

59. Popper represented himself at trial.

60. On or about January 1, 2012, Popper committed suicide, and the Commission subsequently dismissed the claims against him.[118]

Defendant Troy Gagliardi

61. Gagliardi was the Series 24 Manager of the Boca Raton branch office of Brookstreet from March 2006 to June 2007.[119] He was also a Brookstreet registered representative in

[117] TT 1167:7-9.
[118] DE 365.
[119] PTS 38 (DE 232 at 28 of 62).

Brookstreet's Jericho (New York), Deer Park (New York) and Boca Raton (Florida) offices from August 1999 to June 2007.[120]

62. On May 3, 2004, Gagliardi, who was then working for Brookstreet in New York, received an e-mail from Brookstreet's corporate office announcing that on May 14, 2004, at the Brookstreet Annual Product Marketing Conference, there would be an important breakout session led by Popper called "Managed Bond Portfolios in a Rising Interest Rate Market."

63. The e-mail announcement further stated:

> Take this opportunity to hear direct from the firm's largest mortgage backed bond broker and government agency bond portfolio manager on how to greatly increase commission revenue while providing clients access to the dynamic sector of institutional adjustable rate government agency backed bonds. For the last 10 years, Mr. Popper has been working with institutional trading desks throughout the country, buying and selling large multi-million dollar blocks of various Ginnie Mae, Fannie Mae, and Freddie Mac backed bonds and creating individualized portfolios designed to perform well during different interest rate environments. For an understanding of how to attract large assets and offer substantial high net worth clients institutional agency backed bonds, you should attend the informational breakout meeting held on Friday, May 14, from 2:45 pm until 4:00 pm. The trading credits will exceed you expectations. Do Not Miss This Exciting Forum.[121]

64. Word got around that Brookstreet had hired a successful CMO portfolio manager who was bringing a profitable and new product to the firm, and brokers were excited to learn about it.[122]

65. Gagliardi attended the session.[123] Popper told the attendees that the CMO market, which was normally exclusive to institutional investors, was now accessible to retail clients because he

---

[120] PTS 35 (DE 232 at 28 of 62); TT at 1564.

[121] Ex. G-25 (TROY 03256). The Court has reconsidered the basis for which it sustained a hearsay objection to this exhibit and concludes that it was not offered for the truth of the matter of the contents of the e-mail, but rather for the fact that these statements were made. Therefore, these statements are not hearsay. Accordingly, the Court reverses its ruling on this piece of evidence and will allow its admission. DE 356 at 95.

[122] DE 356 at 96-97.

[123] DE 355 at 153.

had designed a program that made it profitable for them.[124] Popper said that the bonds his program invested in were AAA rated or implied AAA bonds, and he had clients that had been with him for years. He claimed returns of 10 or 12 percent.[125]

66. Gagliardi took the black folder that was handed out and read its contents because this was a new product and he wanted to learn as much as possible about it.[126]

67. Gagliardi read all of the materials the CMO Program provided to him and he did some research online. Before attending the CMO Program seminar in 2004, Gagliardi had no prior experience with CMOs.[127]

Brookstreet's Introduction of the CMO Program

68. After attending the CMO Program breakout session in May 2004, Gagliardi received additional information from the Institutional Bond Group in Boca Raton. He received an e-mail from Betta with 11 separate documents attached.[128] Much of the information came from the LaSalle Bond Institute, a website designed to provide brokers with preapproved NASD educational materials.[129]

69. The first attachment was a list of customer references for the CMO Program.[130] All seven CMO customer references were either individuals or married couples. Two of the CMO customer references were retired and another two were semi-retired.[131]

---

[124] DE 356 at 97.
[125] DE 356 at 97.
[126] *See* Ex. G-10, DE 356 at 97-98.
[127] DE 216, Order and Opinion Re: Troy Gagliardi at 11.
[128] Ex. 305.
[129] DE 355 at 153-154.
[130] TROY 03355.
[131] DE 356 at 102.

70. The second attachment had biographical information on Popper which stated, among other things, that Popper had gone to and presumably graduated from Northwestern University.[132] Popper went to, but did not graduate from, Northwestern University.[133]

71. Below that was a paragraph labeled "Program Description" which stated:

> The objective of the portfolios under management is to achieve a combination of income and capital gains that greatly exceeds what is available using traditional fixed income vehicles. The objective is realized by structuring portfolios that include a variety of institutional, adjustable and fixed rate mortgage backed bonds. Bonds are bought in large multi-million dollar blocks and broken up into large individual client accounts... Portfolios are structured to take advantage of interest rate trends in the fixed income market place. Objectives include ***capital preservation*** and high total return. Balancing the portfolio is achieved by purchasing government agency bonds that benefit from rising rates, falling rates, steepening and flattening yield curves, (depending upon market circumstances) (emphasis added).[134]

In this program description, as is the case in almost all communications about the CMO Program from Brookstreet and Popper's group, reference was made to "government agency bonds."[135]

72. The document indicated that Popper was the "portfolio manager of Brookstreet Securities Corp.'s institutional government agency bond portfolios."[136] It stated that Popper "actively manages over six hundred accounts and several hundreds of millions of dollars' worth of government agency bond transactions each year."[137]

73. The same document also included a section called "Hedging" in which it was stated that "[h]edging is accomplished through negative convexity inverse floater bonds... and can also be

---

[132] Ex. 305, TROY 03356.
[133] DE 354 at 44.
[134] Ex. 305, TROY 3356; DE 356 at 102-03.
[135] TT at 1664.
[136] G-11, TROY 03356.
[137] *Id.*

facilitated through the purchase of interest only (I.O.) bonds..."[138] Popper told Brookstreet brokers that he could hedge CMO Program portfolios to do well in an up or down market.[139] Gagliardi understood this to mean that Popper would hedge a bond of one type with a bond of another type, so that if one part of the portfolio moved down, the other part of the portfolio would move up.[140]

74. Another section of the same document was called "Margin and Distributions." Gagliardi and all other Defendants understood from this section, and Popper's representation, that margin was recommended for clients in the CMO Program because it would increase buying power, which would lead to a more diversified CMO portfolio, which would "diversify the risk with more and different types of CMOs."[141] The same document advised that "[l]arger accounts also present the opportunity for greater diversification thus reducing risk."[142]

75. Another attachment to the e-mail was a document called "Institutional Mortgage Backed Bonds." This document states, among other things: "Used in conjunction with each other and with certain other similar instruments, a high level of return ***concurrent with capital preservation*** may be achieved."[143] (Emphasis added). All the Defendants understood from this document, and from Popper's representation, that the CMO Program was going to be a hedged portfolio that would generate good return and preserve capital.[144] Gagliardi testified that "I also took from the document that the credit ratings on these instruments was either AAA or implied

[138] G-11, TROY 03357.
[139] TT at 1666.
[140] DE 356 at 104.
[141] DE 356 at 105, 149.
[142] G-11 (TROY 03358).
[143] DE 356 at 107; TROY 03359.
[144] DE 356 at 105, 107; DE 355 at 210.

AAA, whether it be from a government or a quasi-government agency. It seemed like almost a perfect investment."[145]

76. This document was also given to clients and sets forth a lot of information regarding the CMO Program. Among other things, the document states the following:

> The targeted benefits [of the CMO Program] include: lower transaction costs through direct institutional access, potential above average monthly income, ability to hedge the portfolios against interest rate swings, high credit ratings - primarily investment grade, security of bonds backed by high equity mortgage pools, government and quasi-government agencies, and medium term maturities.
>
> Used in conjunction with each other [inverse floaters and interest only bonds] and with certain other similar instruments, a high level of return concurrent with capital preservation may be achieved.
>
> CMOs are suitable for qualified plans, both individual and institutional depending on investment objectives.
>
> Clients that may be suitable for investment in CMOs include: individuals who have sold real estate holdings or a business, persons seeking potential additional income and equity oriented investors seeking an alternative to the stock market.[146]

77. This document reasonably led readers to believe that if they had sold real estate and were seeking above average monthly income and capital preservation, Program CMOs were suitable investments for them.

78. Another document attached to the e-mail was a "Dear Investor" letter (discussed below) and a pamphlet called "An Investor's Guide to Collateralized Mortgage Obligations." The "Dear Investor" letter and the CMO Investor's Guide pamphlet were included in the "Black Folder" materials Gagliardi always provided to his customers, including the SEC's witnesses that testified against him, Mr. Doherty, the Farugias and Mr. Wolkoff.[147]

---

[145] DE 356 at 105.
[146] G-10; Troy 02355-56.
[147] Ex. 305; TROY 03362; DE 356 at 131.

79. Gagliardi also received a PowerPoint slideshow presentation on CMOs which had been taken from the LaSalle Institute's website.[148] Gagliardi knew it was approved by the compliance department for distribution, and he shared this presentation with all of his clients to educate them as much as possible to help them decide whether or not to invest with the CMO Program.[149]

80. Other attachments to Betta's e-mail to Gagliardi included further informational materials and advertisements for CMOs.[150] According to a document on NASD official letterhead, the CMO advertisements were approved by the NASD in 2003, when Popper was working at another south Florida securities firm, Archer Alexander Securities.[151]

The Black Folder

81. There were two "Black Folders." One that was passed out to Brookstreet representatives at the breakout sessions, and one that was intended for clients.[152] In the Black Folders used at the breakout sessions, there was a lot more information about CMOs, including a "for internal use only" document entitled "Dispel the Myths," materials from the LaSalle Bond Institute, and a PowerPoint presentation.[153] As for the Black Folder intended for clients, it was a simplified version without the PowerPoint presentation, but with the green pamphlet "The Investor's Guide to CMOs," and some Bloomberg historical total return reports and description pages, and the Dear Investor letter.[154]

[148] G-5; Ex. 305; TROY 03364; Ex. 557; DE 356 at 122, 169.
[149] DE 356 at 122-123, 244.
[150] DE 356 at 115.
[151] Ex. G-11.
[152] DE 362 at 69, 78.
[153] DE 362 at 69-70.
[154] DE 362 at 29, 70.

82. The "Dear Investor" letter directed the reader to, among other things, a pamphlet called "An Investor's Guide to Collateralized Mortgage Obligations."[155] The "Dear Investor" letter stated that investments in CMOs "can be appropriate for high net worth investors who are looking for low credit risk, and the potential for a better than average level of monthly income and growth and who can tolerate the inherent volatility associated with the high variability of prepayment speeds of the mortgages that are contained in the bonds' portfolio." The "Dear Investor" letter explained that different types of CMOs would be "blended together in a portfolio to assist an investor in meeting his investment objectives in a variety of interest rate environments." The "Dear Investor" letter also cautioned that investments in CMOs are best undertaken by high net worth individuals with liquid assets to invest of $150,000 or greater. The "Dear Investor" letter further stated that the CMO portfolio with Brookstreet "is an actively managed account." Gagliardi understood this to mean that Popper would make trades to hedge the portfolio in the right direction.[156]

83. Another document included in the Black Folder was a three page informational sheet called "What are Ginnie Maes?" This document describes the history, quality and characteristics of Ginnie Mae CMOs. On the first page, in a section called "What are the Risks?" it states that "[i]f an investor sells a Ginnie Mae before it is paid off, the sale price may be higher or lower than the original investment as the price of the security fluctuates with market conditions." On the second page of the document there is a section called "Benefits." The four benefits described are "*Safety*," "Monthly Income," "High Yield" and "*Liquidity*." (Emphasis added.) The "Conclusion" section states: "Ginnie Mae pass-throughs are government guaranteed investments

[155] Ex. 305; TROY 03362.
[156] DE 356 at 109.

which are attractive to many investors. The combination of safety, yield, liquidity, and monthly income are seldom found in other types of securities. If these are benefits you are looking for, you should consider investing in Ginnie Maes."[157]

84. The 30-page pamphlet entitled "An Investor's Guide to Collateralized Mortgage Obligations," which was not prepared by Brookstreet, sets forth a comprehensive summary of CMOs. Among other things, the pamphlet describes the various types of CMOs (agency and non-agency or "private label" CMOs) and their respective credit qualities. It also describes the different types of CMOs, including Interest-Only and Floating Rate securities. The pamphlet describes various risks associated with CMOs, including prepayment risks. In one section of the pamphlet, it states: "Although there is a sizeable and active secondary market for many types of CMOs, the degree of liquidity can vary widely. *Investors should remember that if they sell their CMOs rather than waiting for the final principal payment, the securities may be worth more or less than their original face value.*"[158] (Emphasis in original). Finally, the pamphlet includes a section with "Questions You Should Ask Before Investing in CMOs," and a glossary of terms.[159] Five of these questions include:

1. Is the CMO
   _____ agency-issued, or
   _____ private label?

2. If it is a private-label CMO, what is its credit rating? _____

3. Is there an active secondary market in this security if I need to sell this CMO before its final principal payment?
   _____ Yes _____ No

[157] Ex. G-10; Troy 02357-59.
[158] Troy 02369 at 17.
[159] Ex. G-10 at 19-20.

4. Given my investment objectives (such as retirement, education, or income and growth), is this CMO appropriate for my account?
_____ Yes _____ No

5. Is there any non-credit related risk of losing some or all of my principal investment in this CMO?
_____ Yes _____ No

85. Gagliardi added Bloomberg screen shots to the Black Folder he provided clients to help educate them about how a Fannie Mae bond "factors down."[160]

86. Gagliardi testified that he handed (mailed or e-mailed) to each of his potential CMO Program customers, without exception, the Black Folder package of information and documents.[161]

87. Gagliardi continued to receive written materials about the CMO Program, all of which he understood to be approved by Brookstreet's compliance department and the NASD.

88. At some point Gagliardi was offered the position of the Series 24 for the Boca Raton branch office. Before accepting, he consulted with Kathy McPherson who ran the compliance department. He asked her, "Kathy, before I move to Florida to go into the CMO group and be their 24, do you see any issues?"[162] He specifically asked her about the Commission's investigation of Cliff Popper in 2004. She assured him that nothing was wrong, but that they wanted to tighten up the policies and procedures for the CMO Program over the next six to 12 months.[163] Gagliardi liked the idea of being in the same location as Popper because he knew if he was just 30 yards away from the CMO portfolio manager, he would learn a lot from just being

[160] DE 356 at 135, Ex. G-10.
[161] DE 356 at 110-111.
[162] DE 356 at 188.
[163] *Id.*

nearby.[164] He did have the opportunity to speak and learn from Popper, and aside from pricing volatility, Gagliardi saw the CMO Program perform as represented.[165]

89. In March 2006, Gagliardi received from Russell Riccobono ("Riccobono") in Brookstreet's compliance department two additional documents.[166] Riccobono wrote, these "are all that we have in the way of [NASD] approved communication[s] for any Brookstreet broker to use regarding CMOs."[167] The first line on the first page states "Registered Representative, [...] of Brookstreet Securities Corporation member NASD/SIPC[168] offers a managed portfolio for high net worth clientele comprised 100% of government agency bonds, Ginnie Mae, Fannie Mae and Freddie Mac."[169] The two documents are a total of nine pages and include the following sub-headings: Key Considerations, The Risk Reward Trade-Off, Market Liquidity; The Composition of Bonds in Your Account; The Costs of This Program to the Individual Client; The Risks Associated With a Portfolio of Mortgage Backed Securities, The Effects of Interest Rates on CMO Values and Prepayment Rates, The Basic Characteristics of CMOs, Various Types of CMOs, and The Tax Considerations for CMO Investors. The last page is an ad with the title, "LOOKING FOR MONTHLY INCOME?"[170]

90. Over time, Gagliardi received a lot of materials from Brookstreet describing the CMO Program and CMOs in general.[171] One was another "Dear Investor" letter from Popper with an attached slide show presentation called "CMOs: Collateralized Mortgage Obligations: A Strong

---

[164] DE 356 at 191.
[165] *Id.*
[166] DE 356 at 120.
[167] G-38, TROY 03297; DE 356 at 242-243.
[168] Securities Investor Protection Corporation.
[169] TROY 03298.
[170] Ex. G-38, TROY 03298-03307.
[171] DE 356 at 121.

Foundation (CMO Basics)."[172] In this "Dear Investor" letter, Popper states that the "primary features [of CMOs] are: implied AAA rating, possible above average level of monthly income, and potential growth/capital gains."[173] The CMO slideshow presentation states, among other things, that CMO benefits include

- "AAA" credit quality
- monthly income
- liquidity (at current market value) and
- diversification of risk.[174]

It states at the bottom, "CMOs are complex securities and are not suitable for all investors." The slide show describes, among other things, the evolution of CMOs, how these complex securities are structured, and their average life and prepayment speed. It is approximately 31 pages long and states that CMOs are issued by Ginnie Mae, Freddie Mac and Fannie Mae and that Ginnie Mae CMOs are backed by the full-faith and credit of the U.S. government, and that Freddie Mac and Fannie Mae CMOs are backed by the credit worthiness of the respective agencies.[175] Additionally, the slide show presentation describes "Whole Loan CMOs," also commonly referred to as "Non-Agency CMOs," as having the "same credit quality as Agency CMOs," except that their "collateral is made up of mortgages that are not eligible to become [Freddie Mac, Fannie Mae and Ginnie Mae] mortgage-backed securities."[176] The slideshow concludes by stating that "investors can count on CMOs to expand their investment choices [because they offer the safety of] AAA credit quality, monthly, fixed-rate income [while receiving an] attractive

[172] G-5.
[173] *Id.*
[174] *Id.*; Troy 02320.
[175] Troy 02322.
[176] Ex. G-5; Troy 02343-02344.

yield, ... liquidity... and diversification of risk."[177] Gagliardi used this slide show presentation, among other materials given to him, to educate himself on CMOs in order to have informed conversations with his customers.

91. Gagliardi understood CMOs to be "relatively liquid" because the CMO market in 2004 was "a one or two trillion-dollar market."[178] Popper never told Gagliardi that Inverse Floaters, IOs and Inverse IOs were exotic types of CMOs with less liquidity than the average CMO.[179] Nor did Popper tell Gagliardi that IOs could prepay in a matter of months. Gagliardi never heard Popper say that the type of CMOs that would be purchased in the CMO Program were only suitable for investors with a high risk profile.[180]

92. For about a year, from around 2004 to 2005, Gagliardi believed the CMO Program invested strictly in AAA's. Sometime in 2005, Gagliardi became aware that 10% of the Program portfolio contained non-agency CMOs.[181]

93. Gagliardi asked Betta why non-agency CMOs had been introduced into the CMO Program. Betta indicated it was to diversify the portfolio with high level AAA bonds which had the equivalent credit quality of government sponsored or agency CMOs.[182]

94. As the Series 24 manager of a branch office, Gagliardi's primary function was to act as a communication intermediary between Brookstreet's corporate and compliance office and the Institutional Bond Group in Boca, Raton, Florida.[183] He supported and helped educate brokers interested in participating in the CMO program, informed brokers of Popper's recommendation

[177] Ex. G-5; TROY 02349.
[178] DE 356 at 114, 130.
[179] TT 1666.
[180] TT at 1667.
[181] DE 356 at 244-250.
[182] *Id.*
[183] DE 356 at 190, 202.

to buy and sell securities in their clients' accounts, and ensured that the participants were sophisticated accredited investors.[184] He also ensured that corporate policies were followed by checking inbound and outbound correspondence, reporting issues to compliance when they arose, and coordinating inspections and examinations of the office.[185]

Gagliardi's Sales of CMOs

95. Out of Gagliardi's approximate 300 clients, 31 were in the CMO Program, 16 of them on margin.[186] Some of these CMO customers were assigned to him by Brookstreet's corporate management and compliance department. In total, Gagliardi had 19 CMO customer accounts that he opened himself, with approximately another 12 accounts that were assigned to him.[187]

96. When Gagliardi received a buy or sell recommendation for a particular CMO from Popper, he would fill-out and sign a trade ticket, and then send the ticket to the Institutional Bond Group. From there, he understood the Institutional Bond Group would work with Brookstreet traders in California to purchase or sell a large block of CMOs.

97. Gagliardi testified that it was his practice to discuss CMOs and the CMO Program with each of his customers before recommending that they participate in the program.[188] He wanted to understand the customer's investment objectives, and assess their appetite for risk. If the customer was looking to generate income through relatively safe investments, depending upon their financial condition, Gagliardi would go over the benefits and risks of the CMO Program.

[184] TT at 1478-1480.
[185] TT at 1733-1734, 1839.
[186] PS ¶ 40; DE 356 at 124-125.
[187] PS ¶¶ 39, 44.
[188] TT at 1670-1676, 1803.

Gagliardi told customers that one of the benefits of most of the types of CMOs purchased in the Program is that principal and interest payments were guaranteed by the government. He told them that the securities were mostly AAA-rated or had implied AAA ratings.[189] He told them that there could be price volatility.[190] He further told them that they could expect, on average, returns of 10% or more.[191] He also explained that it was a managed program, where the client would not be informed every time a bond was bought or sold.[192] Gagliardi also told them that he had invested a considerable sum of his own money in the CMO Program.[193] Regarding margin, Gagliardi told his customers exactly what Popper had told him, that investing in the CMO Program on margin minimized risk by having a larger portfolio with different kinds of CMOs.[194] Gagliardi also told customers that they could sell their CMOs if they wished to leave the program, but that it might take a little time to get the best price.[195]

98. Gagliardi sent out between 30 to 50 Gopal Reports to his CMO Program clients over three years.[196] He had to get permission from the Compliance Department and pay a small fee, but he wanted his customers to have these reports because they more clearly identified, as opposed to Brookstreet's account statements, which investments in the portfolio were IOs, inverse IOs, or inverse floaters, and specified, in an easier to understand format, the amount of principal and interest, how much was in agency or non-agency CMOs, how much margin was being used, and margin interest and expense.[197] He testified at trial that it gave him some

[189] TT at 912-913; DE 356 at 143, 212.
[190] DE 356 at 143-144, 212.
[191] DE 356 at 24, 26, 54, 143, 145, 212.
[192] DE 356 at 144, 151-152.
[193] DE 356 at 26.
[194] DE 356 at 19, 149.
[195] DE 356 at 114.
[196] DE 356 at 137-139.
[197] DE 356 at 139-140.

comfort to keep his clients as informed as possible about what was held in their CMO accounts.[198] Gagliardi's three customers who testified for the Commission, John Farugia, Leonard Patrick Doherty and Michael Wolkoff, all received Gopal Reports.[199]

99. Gagliardi testified that for a period of approximately three years, or until late May 2007, he was confident that Popper had developed a viable strategy for creating balanced portfolios that offset the risks of the individual instruments, creating a relatively stable income vehicle that worked well. It generated average annual returns of 10% or more, customers who wanted to sell CMOs were able to do so, the Program generated substantial monthly income for customers, and the CMOs were highly rated by the independent rating agencies.[200]

100. Also as predicted, there were episodes of severe price volatility.[201] Defendants consistently assert that if NFS's pricing mechanism had not been faulty, this case would not have come to be and investors who had stayed in the Program would have yielded significant returns.[202]

101. On August 11, 2006, Gagliardi got an e-mail from Christensen with a list of his clients who were considered unqualified for the CMO Program. After speaking with each of these customers and updating their financial status and investment objectives, none of Gagliardi's clients stayed on compliance's list of unsuitable CMO Program participants.[203] In particular, none of the testifying investors, Leonard Doherty, the Farugias or Michael Wolkoff, elected to exit the program and be placed on the "sell only" list.[204]

---

[198] DE 356 at 138, 253.
[199] DE 356 at 139.
[200] DE 356 at 221.
[201] TT at 1849.
[202] *See, e.g.*, DE 361 at 57-58.
[203] DE 356 at 199.
[204] DE 356 at 126.

102. In 2006, because of extreme price volatility (20-30% swings), Gagliardi no longer recommended the CMO Program to new clients.[205]

Customer Witnesses Against Gagliardi at Trial

Investor Leonard Doherty

103. Leonard Doherty ("Doherty") was the President and owner of an optical manufacturing company in England.[206] Doherty lived both in Sarasota, Florida and the United Kingdom.

104. Doherty understood that investing was like "a horse race with risk."[207]

105. Doherty first invested in REITs and alternative drilling and oil investments.

106. In June 2002, Doherty signed a Brookstreet New Brokerage Account Application indicating that his investment objectives were appreciation, growth and income, and speculation.[208] Doherty testified that he knew he signed several documents designating his investment objective as high risk, but stated at trial that he was only a high-risk investor with regard to oil investments, and only a medium risk investor with regard to REITS.[209]

107. Even though Doherty repeatedly signed and initialed documents indicating that he was sophisticated in financial and business affairs and was able to evaluate the risks and merits of an investment, Doherty testified that he was not really a sophisticated investor and just signed what

[205] DE 356 at 125-126.
[206] DE 356 at 22.
[207] DE 356 at 54, 155.
[208] Ex. G-1 (TROY 01083).
[209] DE 352 at 56; DE 356 at 78-79.

Gagliardi gave him to sign because he "trusted Troy's judgment."[210]

108. Doherty understood that REITs were not liquid, and that he may not be able to sell his REIT shares.[211]

109. In late May 2004, Gagliardi discussed with Doherty the possibility of investing in the CMO Program. Over the course of many conversations, Gagliardi told Doherty that the CMO Program might be a good investment for him if he was looking to increase income because the CMO Program yielded approximately 10% annually.[212] Gagliardi mailed the Black Folder to Doherty. Doherty testified at trial that he did not read the materials, even though he signed and initialed multiple documents where he agreed that he had read the materials and disclosures, and testified at his deposition that he had read the materials.[213]

110. Thereafter, on or about May 26, 2004, Doherty signed a New Brokerage Account Application which indicated that his annual income was over [redacted] that he had an estimated net worth of over [redacted], and investable assets of over [redacted][214]

111. In connection with opening the CMO account, Doherty signed a NFS Supplemental Application for NFS Margin Account Privileges.[215] Doherty testified that he did not notice, when he signed the application, the bolded, all capitalized statement just above his signature:

I REPRESENT THAT I HAVE READ THE TERMS AND CONDITIONS CONCERNING THIS ACCOUNT AND AGREE TO BE BOUND BY SUCH TERMS AND CONDITIONS AS CURRENTLY IN EFFECT AND AS MAY BE AMENDED FROM TIME TO TIME.[216] (Font size imitated).

112. Gagliardi and Doherty had many conversations about the purpose of margin, and

---

[210] DE 356 at 30, 60, 63, 64.
[211] Ex. G-1 (TROY 0177).
[212] DE 356 at 154.
[213] TT at 1702-1715.
[214] Ex. G-1; Ex. 156.
[215] Ex. G-1; Ex. 158.
[216] DE 356 at 67.

Gagliardi never disguised the fact that Doherty's account was using margin.[217]

113. Further in connection with opening up his CMO account, Doherty signed and initialed Brookstreet's CMO Disclosure Form. Doherty's initials appeared next to each of the statements below and his signature appeared directly under them:

> I understand that I intend on purchasing Collateralized Mortgage Obligations (CMO) securities within my securities account at Brookstreet Securities Corp. through my Registered Representative listed below.
>
> I further understand that:
>
> The primary types of CMOs in my account will be "Inverse-Floating Rate" and "Interest Only" CMOs. In general Inverse-Floating Rate CMOs increase in value when interest rates fall and decrease in value when interest rates rise. Interest-Only CMOs increase in value when interest rates rise and decrease in value when interest rates fall.
>
> CMOs are not the same as conventional debt securities or CDs and the time to maturity may vary as well as the timing of principle received.
>
> The prepayment assumptions (estimates based on historic prepayment rates for each particular type of mortgage loan under various economic conditions from various geographic areas) are factored into the offering price, yield, and market value of a CMO. CMO bonds may pay off more principal than anticipated which may force me/us to reinvest at a lower interest rate.
>
> By selling CMOs rather waiting for the final principal payment, the securities may be worth less than waiting for the final principal payment, and the securities may be worth less than their original face value.
>
> For CMOs purchased at a premium, the guarantee as to principal applies only to the par value of the security and not to any premium paid.
>
> For Interest Only CMOs purchased, if prepayment rates are high, then I may actually receive less cash back than initially invested.
>
> For Inverse Floating Rate CMOs, rising rates will lower interest payments and extend return of principal beyond the anticipated average life. This may increase or decrease the effective yield.

[217] DE 356 at 158.

> All assumptions, opinions and estimates constitute the Registered Representatives' judgment as of this date and along with prices and yields, are subject to change without notice. The yield and/or average life shown consider prepayment assumptions that may or may not be met.
>
> I have received and read the "Investor's Guide to Collateralized Mortgage Obligations" booklet which was provided to me by my Registered Representative.
>
> I (may) intend to place these transactions in a Margin Account. I understand that utilizing a margin loan for the purchase of these securities could require an additional deposit (margin call) of funds/securities in the event of adverse market conditions. Failure to meet these margin calls could result in a liquidation of the securities in the account to meet these calls. Additionally, the use of a margin loan will amplify the effects of an adverse market environment, leading to the possibility of substantial (in some cases, total) loss of equity in the account.[218]

114. Doherty testified that he did not understand margin or CMOs, but that he initialed and signed where required because "I made my mind up to invest in the bond on the information that Troy Gagliardi had spoken to me about."[219]

115. On average, Gagliardi spoke with Doherty twice a week, and met with him once a quarter.[220] Never during any of these conversations did Doherty tell Gagliardi that he did not understand margin or the investments he was making in the CMO Program.[221]

116. Gagliardi and Doherty developed a friendship and they often spoke about Doherty's family, and his horses.[222] Gagliardi met Doherty's wife and daughters on a few occasions in Florida and once Gagliardi met Doherty and his wife in New York City.[223] Even though they were very comfortable with each other, Doherty testified that he never told Gagliardi that he never read the information set forth in the materials he was provided and the forms he was asked

[218] SEC Ex. 157.
[219] DE 356 at 36-37.
[220] DE 356 at 54, 68, 155.
[221] DE 356 at 69.
[222] DE 356 at 56-57.
[223] DE 356 at 52, 54.

to sign.[224]

117. Gagliardi testified that he never told Doherty that CMOs were guaranteed with no risk, and that he explained and Doherty understood that it could take 60 to 90 days to withdraw money from his CMO account.[225] On several occasions Doherty successfully withdrew large sums from his CMO account.[226]

118. On the front page of the monthly account statement for Doherty's CMO account, there is a section just to the right of "Account Activity" called "Margin Profile."[227] The Margin Profile indicates the margin balance in the same size font as the other sections "Portfolio Value" and "Account Activity."[228] For each of the 36 or so separate monthly account statements received, Doherty testified that he never looked at that portion of the statement, and that he only focused on the portfolio total amount.[229]

119. Even though the application indicates his investment objectives were income, growth and speculation, Doherty testified that he believed that his investments in the CMO Program would constitute the safe and conservative portion of his portfolio.[230]

120. At trial, Doherty testified that he never knew he was investing in CMOs, but he readily admitted that whatever he said during his deposition must be correct because it was much closer in time to the facts.[231] Counsel reminded Doherty that he testified at his deposition that he reviewed other materials Gagliardi sent him,[232] and the Court finds that Doherty understood that

[224] DE 356 at 55-56, 59.
[225] DE 356 at 73, 156.
[226] DE 356 at 71-72, 159-160.
[227] SEC Exs.160-162.
[228] *Id.*
[229] DE 356 at 39, 69.
[230] DE 356 at 31-35, 78.
[231] DE 356 at 65-68.
[232] *Id.*

he was investing in the CMO Program, that he understood he applied for a margin account, and that he understood the risks associated therewith.

121. During 2004, 2005 and 2006, Doherty was very pleased with his Brookstreet investments, including his investments in the CMO Program, the REITs and the oil and gas programs.[233]

122. Doherty regularly received checks from the CMO Program and his CMO account performed exactly as predicted by Gagliardi until June 2007.

Investors: The Farugia's

123. John Farugia was a very successful businessman, having held senior executive positions at large companies.[234] Prior to 2007, his average annual income had always been between $500,000 and $750,000.[235] His compensation in 1999 (inclusive of cashed stock options) was 2.2 million dollars.[236] Gagliardi testified that John and Celeste Farugia represented a typical client: high net worth, college educated, earning $300,000-$500,000 or more per year, with some investing experience.[237]

124. John Farugia had recently lost money with another investment adviser and he was interested in finding a new broker.[238] In 2002, the Farugias spent six months talking to Gagliardi and looking at virtual models before they decided to invest with him.[239] Gagliardi put together an investment proposal that suggested John Farugia's 401(k) money be rolled into an individual

[233] DE 356 at 54, 70.
[234] DE 351 at 59-60.
[235] DE 351 at 167-68.
[236] DE 351 at 60-61.
[237] DE 356 at 165, 172.
[238] DE 351 at 70-71.
[239] DE 351 at 78.

retirement account ("IRA").[240] He suggested 35% of their total investments should be in bonds, 45% in mutual funds and 20% in stocks.[241] Of the (45%) mutual fund portion, Gagliardi recommended 20% of that be allocated to CMOs.[242] This model looked fairly conservative and made sense to the Farugia's, so they "moved forward along that direction with [Gagliardi]."[243] Even though he reviewed models carefully before investing, John Farugia testified that he was unaware that he had CMOs in his IRA account.[244]

125. Until John Farugia retired, Gagliardi testified that he communicated about 80% of the time with John Farugia's wife, Celeste. They spoke about two to three times a month, and because they lived near-by each other, when they met, most of their meetings took place in her kitchen.[245] She often asked Gagliardi questions about their various investments. It was Gagliardi's belief that John Farugia's wife, Celeste, handled the finances for the couple.

126. John Farugia testified that in order to achieve his retirement goals, he paid careful attention to how much money he made and how much he spent.[246] But when it came to investments, Farugia made it very clear at trial that he did not consider it his job to understand the various investment vehicles, but rather it was his representative's job to understand his objectives and to put him in the appropriate investments.[247]

127. When the Farugia's met Gagliardi, they had mutual funds, an annuity and a REIT in their IRA.[248] John Farugia testified that prior to investing with Gagliardi in 2002, their

[240] DE 351 at 11.
[241] P-165.
[242] DE 351 at 73-75.
[243] DE 351 at 11.
[244] DE 351 at 99, 169.
[245] DE 356 at 162-164, 170.
[246] DE 351 at 89.
[247] DE 351 at 79.
[248] DE 356 at 161.

investment objective had been conservative.[249]

128. At first, the Farugias invested in mutual funds, stock funds, REITs, and in a gas and oil exploration program, which is an alternative, speculative investment.[250] Specifically in connection with the gas and oil program, John Farugia understood the investment was not liquid.[251]

129. If he signed and initialed a disclosure statement that said that one of his investment objectives is high risk, John Farugia testified that he did not read the document and that he "would never have signed up for high risk at that stage of my life."[252] John Farugia further denies that he and his wife were sophisticated in financial and business affairs or that one of their investment objectives was speculation, even though they repeatedly signed and initialed documents so indicating.[253]

130. Every time they opened an account or made a change, the Farugia's received a confirmation letter which included a statement of his investment objectives, his income, and all the other information that appeared on his application.[254] When he received these letters, he did not call Gagliardi to tell him that his investment objectives were wrong because he did not read the letters.[255] John Farugia never told Gagliardi that he did not read the confirmations that were sent to him.[256]

131. Gagliardi also developed a friendship with the Farugias. Gagliardi attended parties at

[249] DE 351 at 12.
[250] DE 351 at 12, 84-87.
[251] DE 351 at 88.
[252] DE 351 at 87.
[253] DE 351 at 87.
[254] DE 351 at 81.
[255] DE 351 at 81, 87.
[256] DE 356 at 172.

their home, went out to dinner with them, helped with contacts, and volunteered with the Farugias to benefit the American Heart Association.[257]

132. In 2004, Gagliardi thought the CMO Program might be a good supplement to the Farugia's IRA because they did not have any type of bond in their portfolio.[258] Gagliardi met with Celeste Farugia to discuss the CMO Program at the Farugias' home. John Farugia was not present for this meeting. Gagliardi discussed and explained the CMO Program to Celeste Farugia and Gagliardi gave her the Black Folder, which included the various documents and information about CMOs and the Brookstreet CMO Program. John Farugia testified he never saw or reviewed the Black Folder.[259]

133. Gagliardi testified that he never told Celeste Farugia to ignore or not read any of the documents he gave her.[260] Gagliardi never told Celeste Farugia that CMOs were the same as CDs or that there were no risks whatsoever with them.[261]

134. Approximately a week later, Celeste Farugia called Gagliardi and told him that they had decided to invest in the CMO Program in the amount of $100,000.

135. From 2002 through January 2006, the Farugias were very satisfied with the performance of Gagliardi's recommendations.[262] The account received on average 8-10% annual returns, as had been described by Gagliardi before they invested, and during 2006 and part of 2007, the Farugia's received a monthly income of $5,000.[263]

136. The Farugias were so satisfied with the CMO Program that they agreed to appear in a

[257] DE 356 at 170.
[258] DE 356 at 162-163, 244.
[259] DE 351 at 93.
[260] DE 356 at 163.
[261] DE 356 at 165.
[262] DE 351 at 15, 94-97, DE 356 at 164-165.
[263] DE 351 at 99, 169.

commercial about CMOs, but it never aired.[264]

137. In late 2005 or early 2006, the Farugias informed Gagliardi that they were selling their home in New York, which had appreciated considerably in value. They said they wanted to invest the proceeds in a vehicle which would produce income.[265]

138. Gagliardi suggested they put $700,000-800,000 down on the new house they were going to buy and invest the remainder in the CMO Program, which they already had in their IRA and which was doing well.[266]

139. John Farugia testified that he was not really cognizant of the CMO Program until Gagliardi showed him how well it performed from 2004 to 2006 as part of his presentation on where he thought the Farugia's should invest the new capital.[267] They had about three conversations about it.[268]

140. John Farugia testified that Gagliardi emphasized time and time again about how remarkably safe the CMO Program was, and that Gagliardi claimed to have all his retirement clients in it to preserve capital and maximize monthly income.[269] John Farugia also understood that CMOs required only 30 days to liquidate.[270]

141. In 2006, the Farugias put $580,000 into a CMO account because Gagliardi had proven himself reliable, trustworthy, and they had had a four-year profitable relationship with him.[271] John Farugia testified that they considered this their "fall-back money," and Gagliardi knew that

[264] DE 351 at 97.
[265] DE 356 at 165-166.
[266] DE 356 at 166, 174.
[267] DE 351 at 166.
[268] DE 351 at 90.
[269] DE 351 at 17, 105.
[270] *Id.*
[271] DE 351 at 18.

the Farugia's investment objective as to this money was "ultra conservative."[272]

142. John Farugia kept the IRA account with Brookstreet, but a new account was opened in January 2006, and the CMOs in the existing IRA account were transferred to the new account.

143. Gagliardi testified that he warned them that there would be a lot of volatility, like what they had experienced with the CMOs in their IRA account several months before in the fall of 2005.

144. Gagliardi told the Farugia's that they were not required to use margin with the CMO Program but that accounts that were using margin were doing slightly better than strictly cash accounts.[273] Gagliardi testified that he told them that if they wanted to use margin, which he used for his own account with success, that one of their objectives must be speculation.[274]

145. John Farugia testified that Gagliardi explained none of this and just assured him that these investments "were 100 percent as safe as a CD," except with a better return.[275] Even while recognizing that there is a direct link between risk and reward, John Farugia testified that he believed Gagliardi's representation that the CMO Program was comprised of AAA-rated government-backed bonds and was as safe as a CD, but yielded three, four and five percent more.[276]

146. The Farugia's signed a Brokerage Account Application stating that their risk tolerance was moderate, aggressive and a combination; that their investment objectives included preservation of capital, income, capital appreciation, trading profits, and speculation; and that

[272] DE 351 at 20.
[273] DE 351 at 152.
[274] DE 356 at 166-167.
[275] DE 351 at 29, 100, 107.
[276] DE 351 at 100-04.

their investment knowledge was excellent for stocks, bonds, mutual funds, variable contracts and limited partnerships.[277] John Farugia testified, however, that his understanding of bonds in 2006 was not excellent, but rather, "superficial at best," and that his risk tolerance at the time was conservative and their investment objectives were only preservation of capital (as the most important) and income (secondarily).[278]

147. John and Celeste Farugia also both initialed and signed Brookstreet's CMO Disclosure Form.[279]

148. John Farugia testified that he signed and initialed this document, even though he had no idea what an inverse floater or interest-only CMO was.[280] John Farugia testified that he only "superficially looked" at the document that he was asked to sign twice and initial ten times, and in which he was investing his "sacred no-risk" money.[281] The reason he did not concern himself with these disclosures is because Gagliardi, whom he trusted, assured him that he was putting him in a safe investment and he could ignore the disclosures like one ignores a warning label for a drug prescription.[282] Gagliardi denies ever telling any client not to read the terms of the application or disclosure.[283]

149. Also in January 2006, John Farugia signed an application for margin privileges with NFS.[284] Farugia testified that when he asked Gagliardi why they needed a margin account,

[277] SEC Ex. 167, 168, 169; DE 351 at 23-27.
[278] DE 351 at 22-24, 26.
[279] DE 351 at 108-09; Ex. 170; G-57, G-47.
[280] DE 351 at 29, DE 356 at 167.
[281] DE 351 at 110.
[282] DE 351 at 114-15.
[283] DE 356 at 150.
[284] DE 351 at 117.

Gagliardi said "that we're probably not going to use it, but it doesn't hurt to have it, so just go ahead and sign it. It's just part of the whole CMO Program."[285]

150. Celeste Farugia also signed the NFS margin application. By signing the NFS agreement, the Farugias represented that they had read the terms and conditions of the NFS agreement and agreed to be bound by them.[286] Among other things, the NFS margin application discussed in detail that NFS may issue margin calls, and that the accountholders were "liable for payment upon demand of any debit balance or other obligation owed in any of [their] accounts or any deficiencies following a whole or partial liquidation, and [the Farugias] agree[d] to satisfy any such demand or obligation."[287] John Farugia testified that he did not read the terms and conditions of the NFS agreement because he trusted Gagliardi as his financial expert and Gagliardi told them they had nothing to worry about because CMOs were so safe.[288]

151. On January 23, 2006, Gagliardi listed the investment objective priority for the Farugia's in order of importance as: trading profit, speculation, capital appreciation, income, preservation of capital.[289] Compliance made these changes to the Farugia's investment objectives at Gagliardi's direction because Brookstreet required speculation if they were going to invest on margin.[290] According to John Farugia, this was the opposite of what he intended.[291]

152. John Farugia testified that the risks associated with investing in CMOs on margin were never disclosed to him.[292] John Farugia testified that Gagliardi told him, "John, I know never to

[285] DE 351 at 30, 118.
[286] DE 351 at 117.
[287] Ex. 171.
[288] DE 351 at 31, 118.
[289] Ex. 169.
[290] DE 356 at 262-64.
[291] DE 351 at 27.
[292] DE 351 at 142.

put you on margin except for CMOs because of their safety. You have nothing to worry about."[293]

153. In addition to receiving trade confirmations for each CMO transaction, which included all the disclosures listed above under Disclosures, the Farugia's also received monthly account statements for each of their accounts.[294] On the front page, there is a section called "Margin Profile," and the word "margin" is found in multiple places.[295]

154. Gagliardi testified that in 2005 or 2006, he sat down with the Farugia's and went through one of their statements so they understood what was in their account. He showed them which were Fannie Maes, Freddie Macs, Ginnie Maes, where the principal amount was listed and where the amount of interest they were receiving was indicated, and pointed out that there was margin on the account.[296]

155. When he reviewed these statements, John Farugia testified that he focused on the account value.[297] Celeste Farugia also periodically monitored the accounts on line.[298]

156. The Farugia's received and kept over 200 pages of confirmations from Brookstreet.[299] If he had any questions, John Farugia called Gagliardi, who was always available.[300] He did notice the risk warnings on the trade confirmations and he sometimes asked Gagliardi about that. Gagliardi responded that he should not be concerned because the risk was so slight.[301] He called Gagliardi a number of times to inquire about margin and fluctuations in the account.[302] Gagliardi

[293] DE 351 at 143, 152.
[294] DE 351 at 147-148, Ex. G-47, Ex. 173.
[295] Exs. 173, 175, 176, 177; 436.
[296] DE 356 at 173.
[297] DE 351 at 126, 155.
[298] DE 356 at 171.
[299] DE 351 at 122.
[300] DE 351 at 126.
[301] DE 315 at 127-28.
[302] DE 351 at 127.

admitted timing and valuation issues existed, but he always assured John Farugia this was the right place for him to be to protect his principal and maximize his monthly income without risk.[303]

157. John Farugia called Gagliardi a number of times when he noticed his margin balance had become very high. John Farugia testified that Gagliardi told him not to worry about the growing margin because they were invested in CMOs, which were risk-free.[304] "Additionally, he described how margin is needed to buy and sell [CMOs] at the appropriate time, and that... the only reason to utilize margin [was]... to buy some before others were liquidated."[305]

158. At one point, John Farugia saw his principal drop by almost $130,000 in one month. This time, when he called, Gagliardi told him not to worry because NFS had grossly undervalued his investment. Gagliardi followed-up with an e-mail stating the investment in his account was worth almost $100,000 more.[306]

159. From February 2006 to May 2007, the Farugia's received $5,000/month income.[307] The Farugia's CMO account hit its peak principal amount of $649,739.70 in February 2007. (The value in the quarter prior to that was $495,867.78.) At this point the account had a margin balance of about $2.1 million. This alarmed John Farugia but Gagliardi reassured him that margin with CMOs was safe.[308]

160. The next statement, received in June, showed the account had dropped from $649,739 to $337,617.[309]

---

[303] DE 351 at 127.
[304] DE 351 at 31, 34.
[305] DE 351 at 153.
[306] DE 351 at 33, 35-40, 157-58; Ex. 173, 174.
[307] DE 351 at 106; Ex. 175.
[308] DE 351 at 46.
[309] Ex. 176.

161. The next statement reported that instead of having any principal, the Farugia's now owed NFS $236,000.[310]

162. When John Farugia discovered much later that his name was on Christensen's list of unsuitable CMO customers who were to be placed on "sell only," he felt betrayed, believing Gagliardi had maliciously and negligently kept him in the CMO Program.[311] He testified that he had told Gagliardi innumerable times that this investment represented his "sacred no-risk money."[312]

163. The Farugia's were removed from the "sell only" list once their financial information was updated, but John Farugia did not learn that until the trial.[313]

164. The Farugia's sued Gagliardi and the NFS, eventually settling with Gagliardi for $25,000.[314] They also settled with the NFS for $212,000 and for relief of the $236,000 margin call.[315]

165. John Farguia testified that he would never have invested in the CMO Program if he had realized the risk. He testified that Gagliardi told him again and again that they were risk-free and that it was okay to ignore the warnings of considerable risk because these statements were just like the disclosures pharmaceutical companies make about their drugs – necessary for their protection, but the risk is so slight you need not worry about it.[316] This is true even though he saw multiple confirmations that said that inverse floaters were only suitable for sophisticated investors with a high-risk profile, that "IO investors should be mindful that if prepayment rates

[310] Ex. 177.
[311] DE 351 at 43, 119.
[312] DE 351 at 44.
[313] DE 351 at 120.
[314] DE 351 at 50.
[315] DE 351 at 51.
[316] DE 351 at 28, 52, 114, 127, 141.

are high, they may actually receive less cash back than they initially invested," and "utilizing a margin loan for the purchase of CMOs could require an additional deposit (margin call) of funds and/or securities in the event of adverse market conditions. Failure to meet a margin call could result in a liquidation of the securities in the account in order to meet the call. In addition, the use of a margin loan will amplify the effects of an adverse market environment."[317]

166. He felt safe ignoring these warnings because Gagliardi was a licensed expert he trusted, just like he trusts his doctor when he prescribes a medication.[318] "I don't know the medicine. I don't know what I'm taking. I generally don't read the 10-page document that comes with the prescription."[319]

Investor Michael Wolkoff

167. Michael Wolkoff ("Wolkoff") lives in Jericho, New York. Wolkoff is a Senior Vice President at Saks Fifth Avenue Off 5th.[320]

168. Wolkoff has an undergraduate degree from the University of Buffalo, with a major in Business/Human Resource Management and an MBA from the University of Buffalo.

169. Around January 2004, Wolkoff was introduced to Gagliardi by his friend, John Farugia.[321]

170. Gagliardi first met with Wolkoff at Wolkoff's home. During that meeting, they discussed Wolkoff's financial condition and investment objectives. Gagliardi testified that Wolkoff informed him that he had experience investing in stocks, mutual funds and CDs and that

[317] DE 351 at 141-143.
[318] *Id.*
[319] *Id.*
[320] DE 356 at 174-175.
[321] DE 356 at 174.

he did not mind speculating.[322] Gagliardi understood Wolkoff's investment objective to be to maximize growth potential with a diversified portfolio.[323] Wolkoff testified that he emphasized protecting principal and that liquidity was important because he planned on getting married and starting a family.[324]

171. In February 2004, Gagliardi recommended a diversified portfolio for Wolkoff consisting of investments in REITs, annuities, money market funds, and market exposure investments, including stocks, mutual funds and bonds. It was Wolkoff's understanding that every investment Gagliardi recommended for him was in line with his investment objectives.[325]

172. In early March 2004, Wolkoff opened a Brookstreet account. He signed the New Brokerage Account Application, which included as his investment objectives appreciation, growth and income.[326] Wolkoff testified his investment objective should have reflected "other," with protecting principal and maintaining liquidity as his goal.[327] Wolkoff placed approximately $175,000 in the Brookstreet account.[328] Gagliardi never told Wolkoff to ignore any of the information on the application.[329]

173. Wolkoff further invested $100,000 in a REIT alternative investment. In connection with the REIT investment, Wolkoff initialed and signed Brookstreet's Client Disclosure Statement for Direct Participation Programs. In that disclosure statement, by his initials (seven

[322] DE 356 at 181.
[323] DE 356 at 175-176, 178, 181, Ex. G-43.
[324] DE 357 at 9-10.
[325] DE 357 at 40.
[326] G-43 Troy 04653; DE 357 at 12.
[327] DE 357 at 13.
[328] DE 357 at 10.
[329] DE 356 at 179.

times) and signature, Wolkoff acknowledged that the investment was not guaranteed, was not liquid and that Wolkoff was sophisticated in financial and business affairs and able to evaluate the risks and merits of the investment. He also indicated that his annual income was between $201,000 to $300,000, that he had between six to ten years of investment experience, and that his net worth was $2 million with a liquid net worth of $600,000.[330] Still, Wolkoff testified that he was not aware that there was any risk involved with investing in REITs.[331]

174. Thereafter, Gagliardi met again with Wolkoff. Gagliardi testified that he explained the CMO Program to Wolkoff and handed him the Black Folder.[332] Wolkoff testified that Gagliardi never explained what an Inverse Floater or IO was.[333] Gagliardi told Wolkoff that the CMO Program gave a return of 10 or 12 percent a year, that the investments were in AAA implied or Ginnie Maes, Fannie Maes, and Freddie Macs.[334] Gagliardi never told him that CMOs were absolutely guaranteed with no risk whatsoever, but Wolkoff testified that he would not have invested in CMOs if he had known they were not all government backed.[335]

175. After meeting with Gagliardi and discussing the CMO Program in November 2004, Wolkoff opened another account with Brookstreet. On the front page of the New Brokerage Account Application there are computer generated X's indicating that the new account is both a cash and a margin account. It also similarly indicates that Wolkoff's investment objectives were appreciation, growth and income.[336] Wolkoff's signature appears on the third and last page of

[330] G-43.
[331] DE 357 at 46.
[332] DE 356 at 177.
[333] DE 357 at 24.
[334] DE 356 at 177.
[335] DE 356 at 178, DE 357 at 38.
[336] G-43; Ex. 223; Troy 04627, DE 357 at 51-52.

this document.[337]

176. Wolkoff invested a total of $150,000 in the new CMO account, $50,000 of which was transferred from another account.

177. In connection with opening up his Brookstreet account, Wolkoff also signed a Supplemental Application for NFS Margin Account Privileges. In the Margin Account Agreement, Wolkoff represented that "I have carefully examined my financial resources, investment objectives, tolerance for risk along with the terms of the margin agreement and have determined that margin financing is appropriate for me. I understand that investing in margin involves the extension of credit to me and that my financial exposure could exceed the value of securities in my account. I agree to notify my Broker/Dealer in writing of any material changes in my financial circumstances or investment objectives."[338] Wolkoff testified that he did not see the following bolded, all capitalized statement just above his signature when he signed that document:

> **I REPRESENT THAT I HAVE READ THE TERMS AND CONDITIONS CONCERNING THIS ACCOUNT AND AGREE TO BE BOUND BY SUCH TERMS AND CONDITIONS AS CURRENTLY IN EFFECT AND AS MAY BE AMENDED FROM TIME TO TIME.**[339]

178. Wolkoff testified that he had no discussion with Gagliardi about utilizing margin, that he did not intend to open a margin account, and that he just signed and initialed where Gagliardi told him to. Gagliardi was present when he signed these documents, but Wolkoff did not ask him why he was signing a margin account agreement.[340]

179. In 2005, Wolkoff invested $37,500 in the Tall Pines Drilling Program.[341]

---

[337] DE 357 at 56.
[338] G-43.
[339] DE 357 at 52-53; Troy 04632 (original typeface imitated).
[340] DE 357 at 25-26, 46, 53, 59.
[341] DE 356 at 180.

180. Gagliardi and Wolkoff communicated approximately once or twice a month.[342] The only time Wolkoff questioned Gagliardi was when he noticed high commission rates on some of the trades.[343]

181. At some point Wolkoff saw the video commercial made by Gagliardi.[344] Even though the commercial is about collateralized mortgage obligations, he testified that he did not pay any attention to that.[345]

182. Wolkoff received trade confirmations for each CMO transaction occurring in his account.[346] He testified that he often did not open the envelopes, and when he did, he never noticed the words "important CMO information," or "collateralized mortgage obligations."[347] He usually only looked at the account value.[348] Every once in a while he looked at his account online.[349]

183. It was not until sometime in 2005, when he was looking at one of his statements, that he noticed that there was a negative margin balance on his account.[350] He called Gagliardi and Gagliardi sent him a report that listed his CMO balance as much higher. Gagliardi explained that Wolkoff's account was actually worth more, and if he needed to liquidate, he would be able to get more money than either of those two documents indicated.[351]

184. Wolkoff was aware that his Brookstreet CMO account was being managed by Brookstreet and never before June 2007 claimed that any trades of CMOs in his account were

[342] DE 357 at 51.
[343] DE 357 at 44, 47.
[344] Ex. 166; DE 357 at 28, 42.
[345] DE 357 at 42.
[346] Ex. G-48.
[347] DE 357 at 44.
[348] DE 357 at 49.
[349] DE 357 at 45.
[350] DE 357 at 27.
[351] DE 357 at 33-35, 60.

unauthorized.

185. Wolkoff testified that because he trusted Gagliardi, he just signed and initialed, without question, many documents, some of them not filled out, including the following statements, all of which are inaccurate: that he was an accredited and sophisticated investor, that he had a corporation or trust account, that he had six to ten years of experience with a DPP,[352] that one of his investment objectives is high risk, that he was aware that his investment in Inland Western and Paul Bunyan Drilling Program was not liquid, that his net worth increased from $2 million to $3 million from March 2004 to August 2005, and from $3 million to $4 million from August 2005 to December 2005.[353]

Gagliardi's Investments in the CMO Program

186. Gagliardi also invested in the Program on margin and his account was handled just like those of his customers.[354]

187. In June 2007, Gagliardi's account was wiped out in the same way as what happened to some of his customers. Gagliardi never received a margin call, but the CMOs in his account were sold by either Brookstreet or NFS. Gagliardi lost his entire $150,000 investment in the CMO Program.

Findings of Fact regarding the witnesses against Troy Gagliardi

John Farugia

188. At trial, John Farugia presented as a hostile[355] witness. Frequently Mr. Farugia

[352] Not defined at trial.
[353] DE 357 at 15-20, 24-25.
[354] DE 356 at 183, 185-187.
[355] This may have been triggered, in part, by his discovering during a break at the trial that he had been on a list of "sell only" clients. Gagliardi explained during the trial that in his opinion John Farugia's name on that list was solely the result of an administrative error.

completely ignored what was being asked and would instead, take the opportunity to make a case against Gagliardi. He insisted over and over again that "*Gagliardi told me CMOs were 100 percent as safe as CDs, except with a better return!*" The Court does not find that statement credible.

189. John Farugia's testimony was unreliable because he testified both that he never reviewed his account statements, *and* that he noticed the risk warnings on the trade confirmations and called Gagliardi a number of times to inquire about margin and fluctuations in the account. John Fargugia testified that he never saw the contents of the Black Folder, and that he never reviewed the brokerage and margin applications he signed. The Court rejects the notion that a sophisticated businessman would invest his "fall back money" in such an irresponsible and reckless manner, especially given that the Farugia's spent six months carefully considering several different virtual models before deciding to invest with Gagliardi. But after that, according to John Farugia, he purposely ignored all disclosures. It was out of his hands as far as he was concerned. He testified that he never read the margin application he initialed and signed, and he never read the confirmation letters he received which disclosed, among other things, that loses are magnified by margin. The Farugia's were very satisfied with their investments from 2002-2006 and it was in 2006 that Gagliardi sat down and went over every single aspect of their statement with them. His testimony that Gagliardi explained nothing, yet he so believed in Gagliardi that he turned a blind eye to every warning he initialed, is implausible.

190. John Farugia insisted he was careful with his money and conservative, even "ultra conservative," in his investment approach. The Court finds that John Farugia exaggerated how conservative his investment approach was because he signed forms multiple times verifying that

his risk tolerance was much more risky and he also invested in other illiquid alternative investments such as REITs and oil and gas. Nonetheless, the investment plan that the Farugia's initially adopted was relatively conservative. For example, the model the Farugia's accepted was one where 45% of their money was invested in mutual funds, and just 20% of that 45% was invested in CMOs. When the Farugia's received a lump sum from the sale of their residence, Gagliardi made the conservative recommendation that they put $700,000 to $800,000 of that cash down on their new residence.

191. John Farugia testified that, without exception, Gagliardi told him information that was either entirely contradicted by the written documents he signed or received from Brookstreet, or that Gagliardi failed to disclose important CMO information (which was provided to him but he did not read).[356] John Farugia testified that he contacted Gagliardi when he read certain disclosures, for example, that CMOs differ significantly from CDs, or that investing in CMOs is speculative, but Gagliardi consistently reassured him that CMOs were safe government-backed bonds, and were the right vehicle for him based on his investment strategies at the time.[357] This is consistent with what Brookstreet represented to Gagliardi. John Farugia believed Gagliardi based on his repeated assurances, the accounts' performance, and the friendship that had developed between them.[358]

192. There is no doubt Gagliardi represented the CMO Program as safe for retirees. That is what Brookstreet and Popper represented to all Defendants and it was reasonable to rely on the

[356] DE 351 at 137-38.
[357] DE 351 at 133-35, 141.
[358] DE 351 at 135.

firm and the documents that had cleared Brookstreet's compliance department and the NASD.[359]

193. The Commission's other two witnesses did not add anything to their case. Leonard Doherty knew that investing was riskier than betting on a horse race and his testimony was consistent with Gagliardi's. Michael Wolkoff's testimony repeated some of the same complaints made by John Farugia, but Wolkoff also invested in other risky investment vehicles such as REITs and oil and gas programs. These individuals were told what Gagliardi was told, which Gagliardi had every reason to believe was correct. Gagliardi sincerely and reasonably believed the CMO Program was not risky and relatively liquid.

194. The evidence at trial shows that Gagliardi did his best to understand the CMOs that were a part of the CMO Program so he could educate his clients. Gagliardi may not have understood the prepayment risk of IOs, but his clients who testified at trial exhibited a wanton ignorance, which suggests that once they had made the decision to invest in the Program, their curiosity extended to the bottom line and no further. The clients themselves may have read the Black Folder, or not, but not one of them followed the recommendations in the literature to ask Gagliardi certain key questions. All three witnesses recklessly turned a blind eye to warnings that they were required to initial ten times and sign fully. Doherty admitted he did not understand CMOs or margin, but he was willing to take a calculated risk and he never asked Gagliardi to explain further the intricacies of CMOs when they spoke on the phone twice a week or at their quarterly meetings. Doherty was pleased with the results of his investment in the CMO Program during 2004-2006, and, on several occasions during the time that the Program was functioning as promised, Doherty was able to withdraw large sums from his CMO account

[359] DE 356 at 228-229.

without issue.

195. Wolkoff, who has a Master's Degree in business administration, testified that he did not intend to open a margin account, but just signed and initialed where Gagliardi told him to. Gagliardi was present when he signed these documents, but Wolkoff did not ask him why he was signing a margin account agreement.

196. The Commission presented many former Brookstreet clients at trial. With a few exceptions, they all testified that their broker told them exactly what Popper had told their broker: that Program CMOs were safe government backed investments that were appropriate for retirement accounts because they would preserve capital and could be liquidated within 90 days.[360] Many clients were encouraged to invest on margin yet were not properly warned of the risks. If anything, Gagliardi's reliance on his firm, its compliance and legal department, and Popper for his education in and understanding of Program CMOs was merely negligent.[361]

Defendant William Betta, Jr.

197. Before moving to Brookstreet with James Caprio ("Caprio"),[362] and in the beginning of his career with Brookstreet, Betta's role was administrative - he answered the phone, put presentation materials together in preparation for client meetings, attended to the client's comfort, and listened and learned from Caprio.[363] Over time Betta's role became more prominent. He became registered as a broker with Brookstreet and had his own small group of clients.[364, 365] After the 2004 conference in Arizona, and until June 2007, Betta served as the

[360] TT at 2999-3004.
[361] TT at 1566, 1591-1592.
[362] Caprio was Popper's Series 24 supervisor. DE 362 at 23, 25.
[363] DE 362 at 22, 24-25, 31.
[364] When Caprio left, Caprio's accounts were assigned to Betta for a period of one month, and then after that they were moved to Gagliardi. DE 362 at 79-80.
[365] PTS ¶¶ 10, 29 (DE 232 at 26-27 of 62); DE 362 at 31, 55-56.

broker liaison between Popper and the brokers participating in the CMO Program.

198. Betta attended all the Brookstreet conference breakout sessions and handed out educational materials about the CMO Program, including the Program description which stated that objectives included capital preservation, described hedging, and encouraged margin because it would diversify risks. Other materials included the Dear Investor letter, the Guide to CMOs, Popper's CV, references, a PowerPoint presentation, and some marketing materials for the brokers' use.[366] One educational item was a slide presentation.[367] Page 4 of the slide presentation listed "CMO Benefits." According to that presentation, CMO benefits included, among other things, liquidity and that it was appropriate for tax-deferred accounts, such as a retirement account.[368] Betta testified that he told his customers and the brokers that it could take 30, 90 or even 120 days to liquidate a CMO position, depending on the market and the size of the CMO account.[369] However, by September 2006 he was aware that it could take up to seven months to liquidate a CMO account.[370]

199. As the broker liason, Betta was the primary conduit for communications with the Institutional Bond Group. His role was to ensure that the brokers understood the CMO Program, and to help their clients understand the Program, when needed.[371] When brokers raised issues or concerns, he attempted to answer their questions fully based upon his own knowledge, and when necessary, he would consult with Popper or Caprio, and relay the information back to the

[366] PTS, ¶ 32 (DE 232 at 28 of 62); DE 355 94-95, 105 of 263, DE 362 at 32.
[367] DE 355 at 108; Ex. 557.
[368] DE 355 at 110.
[369] DE 355 at 114; Betta Inv. Test. at 283, 3134
[370] TT at 1417- 1418, 1422, 1500-1502; Exs. 146-47, 280, 330A; *see also* Tumminello Depo at 44-45 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix H).
[371] DE 362 at 36; TT at 96.

broker.[372] He understood that the brokers relied on the information he provided them.[373]

200. Betta assisted and facilitated many of defendants' clients to invest in the CMO Program. For instance, Betta coached Kautz on how to explain various trade recommendations to his clients so that Kautz would get the clients' authorization for the CMO trades in their accounts,[374] even though Betta did not have access to customer investment objectives.[375]

201. He knew that Popper promised the representatives that he could deliver well-balanced, hedged and individualized portfolios constructed for their clients.[376] However, he also knew that Popper had nothing to do with the buy or sell recommendations made to the brokers for their clients.[377]

202. One of the documents he distributed to brokers stated, "[c]omputer models are used extensively in determining the proper allocation of bonds, interest rates and maturities within an individual's account."[378] However, Betta was aware that computer models were not involved in deciding which bonds were allocated to any account.[379] The allocation of bonds into specific accounts was performed by Popper's trading assistants, Ms. Tomasini and Mr. Dickson, who also did not have access to customers' investment objectives.[380] He also knew that Ms. Tomasini and Mr. Dickson allocated CMOs to specific customer accounts based on a spreadsheet that showed how much cash was available in each account.[381]

---

[372] DE 355 at 95, 145-146; DE 362 at 31-32, 35.
[373] DE 355 at 148.
[374] DE 358 at 30-31.
[375] DE 362 at 51.
[376] DE 355 at 150, 152.
[377] *See, supra*, fn 61.
[378] DE 355 at 151, Ex. 305 at TROY 03360.
[379] DE 362 at 83-84.
[380] DE 355 at 97-98, 149; DE 362 at 39.
[381] DE 362 at 81-85.

203. Betta advised the brokers about the trade recommendations for their clients' accounts.[382] Ms. Tomasini and Mr. Dickson generated buy or sell recommendations with proposed allocations of CMOs to particular customers' accounts, which recommendations were faxed or emailed to the brokers at Betta's direction.[383] The fax or email included a Bloomberg description page, the buy or sell recommendation, and a trade ticket. Betta would then call the brokers to explain why a particular bond was being bought for or sold out of his customer's account for each trade.[384] He assured broker Kornfeld that the process for allocating CMOs to specific customer accounts was more scientific than a matter of whoever had cash in their account, knowing this was inaccurate.[385] In stark contrast to everything the brokers were told, Betta testified that it was the individual brokers responsibility to make sure the CMOs were suitable for their customers.[386]

204. Betta was aware that inverse floaters and IO CMOs were the primary types of CMOs purchased by the CMO Program, and that these types of CMOs were riskier than a fixed rate or regular CMO.[387] Betta also understood that investing in IOs was not consistent with an investment objective of capital preservation,[388] yet he distributed materials to brokers indicating that the CMO Program was operated in a manner consistent with capital preservation.[389] He told brokers that the Program was appropriate for "sophisticated accredited-type investors,"[390] when he knew the Program was only appropriate for sophisticated investors with a high risk profile.

205. In mid- to late- 2005, he also knew that non-agency CMOs were purchased for

[382] TT at 1479, 1482, 3126.
[383] DE 355 at 98.
[384] DE 355 at 98, 100.
[385] DE 362 at 82-85, Ex. 614.
[386] DE 362 at 51.
[387] DE 355 at 119-122.
[388] DE 355 at 121-122.
[389] *Id.* at 121-122.
[390] DE 355 at 126.

customers' accounts and that this type of CMO was not suitable for the accounts of customers seeking capital preservation.[391] Despite this knowledge, he continued sending out the same materials that represented that only agency CMOs would be purchased even though non-agency CMOs made up about 10% of the Program.[392]

206. Betta understood that an inherent risk of margin is that when asset prices drop, margin levels increase, and that a clearing firm could change its margin requirements at any time.[393] Betta encouraged clients to invest on margin even though no one in the Institutional Bond Group, including Betta, had access to customer investment objectives.[394] Nonetheless, Betta told Shrago's customers that use of margin in their accounts would be limited and thus would pose no risk of margin calls, and that the income from their portfolios would eclipse any margin interest they were being charged.[395] Shrago's client Claudia Johnson testified that Shrago had talked to her about margin for months, but it was Betta who really pushed her to go on margin, stating that Popper could buy more and her returns would be better.[396] He also knew that using margin with the CMO Program was only appropriate for an investor whose investment objective was speculation, and that a margin account was inappropriate for clients whose primary investment objective was income.[397]

207. Kautz, a broker with very limited knowledge or experience with CMOs, relied heavily upon Betta, especially when it came to explaining the benefits of margin to his customers. Betta assured Kautz and Kautz assured his clients that there had never been and would never be a

[391] *Id.* at 122, 157, 161; DE 362 at 64.
[392] DE 362 at 77-78.
[393] DE 362 at 92.
[394] DE 355 at 95-97, 163, 165; DE 362 at 51.
[395] DE 359 at 136; TT at 2615.
[396] TT at 80-81, 181.
[397] *Id.* at 123.

margin call, that margin was securely provided by National Financial Services, and having CMOs on margin was like having treasuries on margin.[398]

208. The evidence above shows Betta made material misrepresentations and failed to disclose material information to brokers and brokers' clients about Program CMOs and the CMO Program. Betta misrepresented to brokers and brokers' clients that Program CMOs were safe investments that were appropriate for retirees, retirement accounts, and/or investors with conservative investment objectives. Betta perpetrated Popper's lie that CMO allocation recommendations were based on computer models and other scientific methodology when he knew that it was based merely on who's account had cash to make a purchase. He knew that the allocation of bonds into specific accounts was performed by Popper's trading assistants who did not have access to customers' investment objectives. Betta misrepresented to brokers and brokers' clients that Program CMOs presented low or no risk to client's principal. Betta misrepresented to brokers and brokers' clients that Program CMOs were backed by the United States government. Betta misrepresented that Program CMOs were easily sold and/or could be liquidated within 30 to 90 days. Betta misrepresented the nature, use, or extent of margin that would be used in the CMO Program accounts and omitted the risks of investing on margin. Betta did not disclose that Program CMOs were only suitable for sophisticated investors with a high-risk profile.

Defendant Steven I. Shrago

209. Defendant Steven I. Shrago was a registered representative in Brookstreet's St. Petersburg, Florida office from January 2000 to June 2007.[399] Shrago has a Series 24 securities

[398] DE 358 at 36-37; DE 357 at 32-34, 124.
[399] TT at 2587, DE 359 at 109.

license, which allows him to run his own office.[400] Most of his clients were retirees.[401] He represented himself at trial.

210. Shrago began recommending CMOs to his clients after attending the CMO Program's breakout session at the 2004 Brookstreet annual conference.[402] Popper was introduced by Stan Brooks as a "government bond principal" or expert. Popper said he had the ability to purchase bonds for a retail investor at institutional prices and investing in the CMO Program was appropriate for retirement accounts because the portfolio would consist of stable government backed bonds that produced good income.[403]

211. Brookstreet brokers were asked to compose a list of customers who had $100,000 to invest who were looking for income and stability of principal.[404] Shrago identified approximately 30-35 customers from his client base of approximately 150, and 20 of those invested in the CMO Program.[405] Shrago's mother and a good friend were among those 20 investors.[406] He gave each customer a Black Folder.[407] All account opening documents were sent to Brookstreet's compliance department.[408]

212. Prior to the spring of 2004, Shrago had very little experience with CMOs. Before recommending the CMO Program to any of his clients, he went to the Boca Raton office a couple of times.[409] He saw the CMO Program as an "overall money-managed account" and he was, at

---

[400] TT at 2586, 2588, Ex. 554.
[401] DE 359 at 118.
[402] TT at 2588.
[403] DE 359 at 118, 121-23; TT at 2588.
[404] DE 359 at 117-119.
[405] DE 359 at 115.
[406] DE 133-22 at 6.
[407] *Id.*; Ex. 485.
[408] DE 359 at 172.
[409] DE 359 at 110.

this point in time, unaware of the types of CMOs purchased.[410] Betta often helped Shrago explain the CMO Program to his customers.[411]

213. According to what he was told, Shrago described the CMO Program as an income-generating investment that was appropriate for retirement accounts. He told his clients that they would be able to take at least 10 percent a year as income, without reducing principal, with the only risk being a five to 10 percent fluctuation in their portfolio values.[412]

214. Shrago brought two of his clients, Claudia Johnson and Luis Fernandez[413] to Boca Raton so they could hear firsthand about the Program from the portfolio manager. When they met with him, Popper explained the different types of CMOs that he would be purchasing.[414]

215. Shrago understood from Popper that it would take about 90 days to redeem an account.[415]

216. Popper and Betta told Shrago that the Program purchased government agency CMOs for his clients' accounts,[416] but in 2006, Shrago became aware that non-agency CMOs were also being purchased.[417] Shrago understood that non-agency CMOs are less creditworthy and do not carry the express or implied backing of the federal government.[418] At about the same time, Shrago read an article about risky collateralized debt obligations or CDOs. He called Betta and expressed concern about the Program, but Betta assured him that the credit quality of the

---

[410] DE 359 at 118.
[411] DE 359 at 121.
[412] DE 359 118-119, 125.
[413] Luis Fernandez invested in two stages. Initially, he invested "a smaller" amount, and then, after he met with Betta and Popper, he eventually increased his investment to approximately $360,000. Fernandez Depo. p. 24-25 (*see,* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix B).
[414] DE 359 at 171.
[415] DE 359 at 123; TT at 2602.
[416] TT at 2602.
[417] DE 359 at 122, 139.
[418] DE 359 at 122-123.

non-agency CMOs was much higher than the CDOs that he had been reading about.[419]

217. Shortly before margin was recommended to his customers, Shrago had been complaining to Betta about the performance of his customers' accounts which were down about 15 percent.[420] Betta and Popper told him that putting his clients on margin would help them recover some of their lost portfolio value.[421] Betta and Popper proposed to Shrago that Claudia Johnson, Robert Boyle and Luis Fernandez be signed up for margin privileges.[422] At that time, Shrago did not have any experience with margin.[423] Betta and Popper told Shrago's customers that it was okay to use a lot of leverage with CMOs because they were government backed and AAA rated.[424] Popper and Betta told his customers that use of margin in their accounts would be limited and thus would pose no risk of margin calls, and that the income from their portfolios would eclipse any margin interest they were being charged.[425] Fernandez testified in his deposition that Shrago did not recommend that he go on margin, and that he only applied for margin privileges based on Popper's recommendation.[426] Johnson testified that Shrago had talked to her about margin for months, but it was Betta who really pushed her to go on margin, stating that they could buy more and her returns would be better.[427] However, when she signed the margin agreement, she refused to initial item number 10, which stated that she could lose all the equity in her account.[428] None-the-less, she was aware that her account was being traded on

[419] DE 359 at 140.
[420] DE 359 at 133-134.
[421] DE 359 at 134.
[422] DE 359 at 133.
[423] DE 359 at 135.
[424] DE 359 at 134-135.
[425] DE 359 at 136; TT at 2615.
[426] Fernandez Depo. 65-66 (*see,* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix B).
[427] TT at 80-81, 181.
[428] Johnson Depo. 69, 71 (*see* Shrago Designation of Deposition Testimony to be Presented at Trial, DE 275). TT at 74-75, Ex. 71.

margin, that her account could have a margin call wiping out her principal, but she was assured that that would never happen.[429] Shrago did not monitor the margin levels in his customers' accounts because he expected Popper to do that.[430]

218. When Johnson first invested with Shrago in 2003, she signed documents acknowledging that she was a sophisticated investor in financial and business affairs, and was able to evaluate the risk and merits of an investment that was not liquid and not guaranteed.[431] She testified that when she signed the document, her net worth was not indicated, and that when it was added later, it was too high. She also disagreed that she had more than 10 years of investment experience or a high risk tolerance.[432]

219. Before she invested in the CMO Program, Johnson asked Shrago to buy 25,000 shares of Annaly Mortgage, a stock she researched which exclusively bought and sold CMOs, suggesting that she was a sophisticated investor.[433]

220. Shrago and Johnson spoke "at great length" about the CMO Program before she decided to invest in the Program.[434] Johnson initially invested $115,000 in December 2004.[435] She received and signed documents containing the material risk disclosures concerning the CMO Program. She read the disclosures and accepted the risks, but she testified that she did not understand the majority of the items she initialed.[436] Johnson did not ask Shrago to clarify or explain them, and did not consult an accountant or attorney about the Program. Johnson testified

[429] TT at 132, 136.
[430] DE 359 at 136-137.
[431] TT at 116-117.
[432] TT at 112-114, 127; Betta Ex. 10.
[433] DE 359 at 147, 151, Ex. J1, J35.
[434] TT at 63.
[435] TT at 71, 73.
[436] TT at 183-184.

that all that she understood was that she was investing in government bonds.[437] She read the Investor's Guide to Collateralized Mortgage Obligations, but did not understand it.[438] Multiple times during the trial Johnson could not identify her signature or initials on various documents.[439] She testified that Shrago inaccurately checked on her investment profile[440] that her investment objectives included growth,[441] capital appreciation and trading profits, that it overstated her net worth, that her risk tolerance was not aggressive, and she did not feel that her investment knowledge was good, but rather, limited.[442] She testified that she did not see her investment profile filled out with these investment objectives, experience, risk tolerance and financial condition.[443] In 2005 she raised concerns about the lack of pricing in her CMO account, and in 2006 she raised concerns regarding the use of margin on her account.[444]

221. Johnson received and read her monthly CMO account statements, which Johnson admitted contained disclosures about margin accounts. Johnson also accessed her accounts online.[445]

222. Johnson testified that she asked Shrago two or three times between August and December 2006 to take her accounts off margin, and she was frustrated because it was taking too long.[446]

223. However, two months before the June 2007 margin calls, Johnson again invested in a

---

[437] TT at 76.
[438] TT at 118-124.
[439] TT at 78-79,
[440] Ex. 70.
[441] Shrago testified that after he got Christensen's email that his customers in the CMO Program needed to have growth and income as their investment objectives in order to stay in the Program, he spoke with Johnson, and she agreed to have those objectives added. TT at 2622-2623.
[442] TT at 95-99.
[443] TT at 99.
[444] TT at 101.
[445] TT at 128-129.
[446] TT at 138-141.

high risk investment with Shrago ($25,000 in a "stem cell account"), in which she acknowledged that she was a sophisticated investor, that she had a high risk tolerance, and that her investment objectives were aggressive growth and speculation.[447]

224. Fernandez was Shrago's friend. Fernandez's annual income was $200,000, his total net worth was $1 million, and his liquid net worth was $160,000.[448] In addition to participating in the CMO Program on margin, he invested in the International Stem Cell direct participation program.[449] Fernandez initialed the statements that said: "I/we are sophisticated in financial and business affairs and are able to evaluate the risks and merits of an investment in this offering," "I/we confirm that one of our investment objectives is high risk," and where it says "Risk Tolerance," high risk is checked.[450]

225. The third paragraph on the second page of the booklet entitled "Institutional Mortgage-backed Bonds" describes the type of person for whom the CMO Program was appropriate. Shrago testified that was exactly the types of clients he had:

> "It talks about people that sold real estate holdings, like Luis Fernandez; business persons like Claudia Johnson; and equity orientated investors, like Robert Boyle; and my mother buys stocks. She's been a stock -- she was married to a stockbroker for 30 years; she's big into stocks. And it fit those type of people, and I thought they were suitable."[451]

226. Shrago added a small percentage of Program CMOs to most of his clients' portfolios because he truly believed, given the mix of the investments they had in their portfolios, that it was suitable.[452] He stated at trial: "The Brookstreet managed CMO Program, at the time, was a good fit as a diversification from the recommendations I had been making to my customers. I

---

[447] TT at 141-153.
[448] DE 359 at 180.
[449] TT at 2655-2656.
[450] DE 359 at 177-178, *see also* Ex. F11, TT 2657 - 2661.
[451] DE 359 at 163.
[452] DE 359 at 147.

believe I created a balanced portfolio of a variety of fixed income investments including municipal bonds, corporate bonds, and added the CMO Program as approximately 25% allocations to create a balanced portfolio which was suitable for my clients."[453]

227. In August 2006, Shrago received Christensen's e-mail with a list of his customers identified as unsuitable for the CMO Program. All but three of his customers were on the list. Shrago testified that he spoke with each of his customers and told them that in order to stay in the CMO Program they had to add growth and income to their investment objectives.[454] After August 14, 2006, Shrago continued signing trade tickets approving the purchase of Program CMOs in his customers' accounts, but he did not open any new accounts, except for Fran Rives, who specifically requested to be in the Program because her husband was in it and was very happy.[455]

228. The Commission asserts, among other things, that Shrago was extremely reckless in failing to investigate Betta and Popper's representations regarding the safety of margin and recommending that his clients use margin when he had no prior experience with margin himself.[456] While the trial testimony of Johnson, and the deposition testimony of Fernandez, may have shown Shrago to be negligent, it did not show by a preponderance of the evidence that Shrago acted with scienter or was severely reckless in recommending the CMO Program or margin to his clients.

Defendant Alfred B. Rubin

229. Alfred B. Rubin worked in the insurance industry for over 20 years before meeting

[453] DE 347 at 2-3.
[454] Ex. 73; DE 359 at 142-143.
[455] DE 359 at 143-144.
[456] DE 343 at 68 citing TT at 2614.

Barry Kornfeld ("Kornfeld"), and becoming employed with him in Brookstreet's Coral Springs, Florida branch office.[457] Kornfeld was a seasoned stock broker with over 20 years of securities experience and he had extensive knowledge of CMOs.[458] Rubin's initial duties at Brookstreet involved the offer and sale of insurance products, but subsequently he obtained Series 6, 7, 24, 63, and 66 securities licenses.[459] Rubin was a broker in the Coral Springs office from January 2004 to June 2007.[460] Kornfeld had been the Series 24 managing supervisor of that branch except when he was forced to relinquish that role and Rubin took over from December 2006 to June 2007.[461]

230. The Coral Springs office had about 160-170 clients, obtained through advertisements and referrals.[462] During this time, 90% of Rubin's business was in the CMO Program. Rubin relied heavily on Kornfeld's judgment because securities was not his background or area of expertise.[463] Rubin relied on Kornfeld, and the firm's compliance department, to review all customer new account forms to ensure that applicants were suitable for the CMO Program, and continued to meet Brookstreet's evolving requirements.[464] Moreover, Kornfeld monitored the accounts on a daily basis and was in frequent contact with all the customers.[465]

231. Rubin was aware of NASD Notice 93-73 because he had been told that was the focal point of the Commission's investigation regarding why CMOs were being sold to retail clients.[466] He was never told that trading odd lots of CMOs made them more difficult to sell or reduced

[457] DE 361 at 94.
[458] PTS ¶ 68 (DE 232 at 31 of 62), DE 360 at 89, 98-99, 130-132, 135-136; DE 361 at 97.
[459] TT at 2810-2811.
[460] PTS ¶ 68 (DE 232 at 31 of 62), DE 232 at 31.
[461] DE 354 at 1242, 1246-47, DE 355 at 1512, 1527-28, DE 356 at 131, DE 361 at 2995.
[462] DE 356 at 140.
[463] DE 361 at 96-97.
[464] TT at 631, 2821-22, 2853-54, 2856, 3026; DE 360 at 77-78, 92, 99-100.
[465] DE 360 at 100.
[466] DE 360 at 118-119, 138.

their selling price.[467] He only knew what he was told by Popper and his team, which included that there was a range of investment profiles that could render someone suitable for the CMO Program, including retirees and retail investors with conservative investment objectives, that investing on margin was advantageous because it would allow customers to diversify by purchasing more Program CMOs, that Popper determined the level of margin to be used by a specific investor, that the Program was not risky because Popper had the skill and expertise to create a hedged or balanced portfolio by combining IOs and inverse floaters to achieve a high level of return concurrent with capital preservation, and he had the right to decline a buy or sell recommendation for his clients.[468] He understood that the bonds in the CMO Program were primarily Ginnie Maes, Fannie Maes and Freddie Macs. If not, they were AAA, diversified within the accounts and actively managed.[469] Popper and his team represented that risk was mitigated by the fact that there was diversification within the accounts based on modeling and other advanced analytical tools.[470] There came a point in time where non-agency CMOs were incorporated into the Program and it was always explained that they were going to be of the highest quality, predominately AAA.[471] Rubin's understanding with respect to the liquidity of Program CMOs was that it was a trillion-dollar industry, and given enough notice (60-90 days or more), sell requests could be accommodated.[472]

232. When he first started working for Kornfeld, Rubin's primary role involved administrative duties and customer support on behalf of Kornfeld, which included, among other things,

[467] DE 360 at 119-120.
[468] DE 360 at 120, 127-128, 136-137, 142, 147; DE 361 at 102-105.
[469] DE 361 at 102.
[470] DE 361 at 103, 108.
[471] DE 360 at 142, DE 361 at 101.
[472] DE 361 at 103.

returning calls to individuals who left messages requesting information regarding CMOs, setting up appointments for potentially qualified investors to speak with Kornfeld, and providing follow-up information and customer service to clients as directed by Kornfeld.[473]

Rubin's Knowledge Regarding the CMO Program

233. When he joined Brookstreet, Rubin testified that he understood that the firm was a national broker-dealer, headquartered in Irvine, California, which employed hundreds of registered representatives located in various branch offices throughout the United States.[474] Rubin also understood that all of the policies and procedures relating to Brookstreet and the CMO program, including those relating to suitability or use of margin, were reviewed, approved and/or created by Brookstreet's legal and compliance department at the home office, with consultation from the firm's outside expert securities counsel.[475]

234. Rubin testified that he understood that Brookstreet's home office selected the investment products that its registered representatives were authorized to offer to the firm's customers.[476] The CMO program was one such approved investment product that Brookstreet, its executive management team, and the Institutional Bond Group aggressively promoted to its representatives, including Rubin.[477] The CMO Program was continually marketed to the representatives in a variety of ways, including through firm wide e-mails, annual product marketing conferences, break-out sessions, monthly market commentaries, as wells as firm wide conference calls with Popper.[478]

---

[473] DE 360 at 93-94; AR-74, 75a, b, c, 76.
[474] TT at 232-33, 2996; Rubin Ex. 3.
[475] TT at 2996-98, 3009-11, 3026; Rubin Ex. 9, 37, 78-A; SEC Ex. 21, 306, 391, 516, 521, T-65, T-66, T-67.
[476] TT at 2996.
[477] TT at 197- 201, 231-32, 632, 763-68, 2956-58, 2998, 3039-40; Rubin Ex. 3, 11, 46; SEC Ex. 207, 239, 305, 334, 336, 557.
[478] *Id.*; DE 356 at 121.

235. Rubin understood that Popper had been managing a CMO program for several years prior to joining Brookstreet and that his program had been performing very well.[479] Rubin understood that Popper was making all of the bond trading decisions, as well as making all client allocation and liquidation decisions for all customer accounts in the CMO program.[480] He testified that he also believed that Popper and his team had access to all client account information, including information relating to the clients' investment objectives and risk tolerances.[481]

236. Popper's background and successful experience in managing CMO bond portfolios was continually promoted by Brookstreet's management to the firm's representatives, as well as by defendant Popper himself and his associates in the Institutional Bond Group.[482] Rubin testified that the registered representatives were told that computer models were used extensively in determining the proper allocation of bonds, interest rates and maturities within an individual's account.[483] These same representations were also contained on a document entitled "Institutional Mortgage Backed Bonds" which was included in the Black Folder that Brookstreet provided its members concerning the CMO Program.[484]

237. Brookstreet, Popper and other associates within the Institutional Bond Group repeatedly made representations and assurances to the firm's brokers regarding the safety and suitability of the CMO program for retail clients, including, but not limited to representations that the CMO program: was being actively managed by Popper; that it purchased only high quality bonds (that were AAA rated and/or carried direct or implied government guarantees); that it was well

[479] TT at 2863, 2999.
[480] TT at 2999-3003, 3005-06, 3008-09, 3012; Rubin Ex. 3, 11.
[481] TT at 3000-01, 3003-04, 3043-45; SEC Ex. 614.
[482] TT at 1534-35, 3002, 3005, 3012; Rubin Ex. 3, 11; SEC Ex. 207, 305.
[483] TT at 1534-36, 3001, 3006.
[484] TT at 3005-3006; Rubin Ex. 3; SEC Ex. 207, 305, 336.

diversified and balanced in order to reduce risk; and that it was suitable for a wide variety of clients with a variety of investment objectives from conservative to aggressive.[485]

238. In order to obtain a forum in which to provide regular reassurances and relevant information to Brookstreet's representatives regarding the CMO program, Popper wrote and had distributed regular "market commentaries" to all the firm's representatives in the CMO program.[486] Compliance permitted Popper to send these commentaries to the representatives on a regular and ongoing basis, as well as, to hold firm wide conference calls with the representatives, from 2004 until Brookstreet's closing in June 2007.[487]

239. Brookstreet's enthusiastic endorsement of Popper and the CMO Program, together with the regular market commentaries and conference calls with Popper, contributed to Rubin's belief in Popper's expertise.[488]

240. Rubin testified that potential CMO clients were not aggressively solicited or pressured into investing in the CMO Program.[489] Instead, there was an "educational process" that occurred with any prospective client who contacted the Coral Springs office for information relating to CMOs.[490] This educational process took place over a period of weeks, and in some cases, months.[491]

241. Rubin understood that the purpose of this deliberate process was to ensure that the prospective client fully understood the CMO Program and that the firm could be confident that the prospective client's investment objectives, experience, risk tolerances and financial condition

[485] TT at 2999-3003; 3005-06, 3008-09, 3012; Rubin Ex. 3, 11; SEC 207, 239, 305, 336.
[486] TT at 763-67, 1250-51.
[487] TT at 763-67, 1250-51, 1255, 2998.
[488] TT at 3002, 3012.
[489] TT at 3022.
[490] TT at 3014-3026.
[491] TT at 3022.

were in line with firm's suitability requirements.[492] Generally speaking, this process involved at least one mini-group meeting with Kornfeld where the CMO Program was fully explained, and one or more additional individual meetings with Kornfeld, where the individual's financial situation, prior investment experience, risk tolerances and investment objectives were discussed.[493]

242. Before they met with Kornfeld, Rubin testified that he advised prospective clients that the minimum investment in the CMO Program was $100,000; that the investment would be actively managed by a portfolio manager and team, and that the investment involved marketable securities that could go up or down in value.[494]

243. When a prospective client met with Kornfeld, he went over in detail the written materials contained in the Black Folder.[495] Rubin testified that among other things, the prospective client was advised that various types of CMO's would be purchased within their account in order to provide diversification, including inverse floaters, principal only and interest only CMOs; that the portfolio manager and his team were responsible for bond selection and allocation in the accounts; that the client could take monthly income out of the account if they wanted; and that most of the bonds were government agency-backed bonds or AAA rated bonds.[496] The prospective clients were also informed that, because the CMO's were purchased in a block form and allocated in odd lots to the individual client accounts, Brookstreet would need approximately 60 to 90 days advance notice to accommodate any significant withdrawals.[497] Kornfeld also

[492] TT at 3023, 3025.
[493] TT at 3014-3026.
[494] TT at 3015-16, 3018-18; SEC Ex. 38, 212, 213.
[495] TT at 3019-20.
[496] TT at 3020.
[497] TT at 3020-21.

advised the prospective client that the CMOs were marketable securities that could increase or decrease in value, particularly if they were sold prior to maturity.[498] Rubin testified that he never heard Kornfeld tell a prospective client that the CMOs were "guaranteed" or that the client could not lose money from their investment.[499]

Rubin's Understanding Regarding Legal/Compliance Department's Role

244. Representatives who participated in the CMO program, including Rubin, received continuous supervision and instructions from Brookstreet's legal and compliance department regarding the parameters of the Program.[500] The compliance department attended Popper's annual conference break out sessions, sent emails about the Program and presumably approved the information contained on Brookstreet's website.[501] Rubin personally attended these conferences from 2004 through 2007, and was aware that the conferences were also being attended by Brookstreet's outside securities counsel.[502]

245. At some point, Brookstreet's legal and compliance department implemented firm wide policies, practices and procedures, which required that certain written disclosures be provided to all customers in the CMO program, as well as requiring that the investors acknowledge their understanding of the related risks associated with the CMO Program by signing and initialing the CMO Disclosure Form.[503] Rubin further understood the firm had hired both an in-house legal counsel (Julie Mains), as well as an outside securities counsel (Tom Fehn) who reviewed the

---

[498] TT at 3019-20.
[499] TT at 3019-20, 3021.
[500] TT at 656-57, 684-87, 1247-48, 1250-51, 1255, 2996-98, 3009-11, 3026, 3045, 3047-49, 3059; Rubin Ex. 9, 37, 46, 78-A; SEC Ex. 21, 73, 100, 169, 250, 299, 300, 301, 305, 306, 330-A, 341, 383, 384, 391, 502, 516, 521, 557, 563, 594-B, T-65, T-66, T-67, T-380.
[501] TT at 1247-48, 1250-51, 1255, 2982; Rubin Ex. 3, 11.
[502] TT at 2997-98.
[503] TT at 2996-98, 3009-11, 3026, 3045, 3047-49, 3059; SEC Ex. 65, 66, 306, 557.

CMO Program's policies and procedures.[504]

246. Rubin understood that the use of these disclosures materials and risk acknowledgments forms was mandatory, and being applied consistently throughout the firm.[505] In addition, Rubin was aware that these policies and procedures were, in fact, being utilized at the Coral Springs branch office where he worked.[506] Rubin, himself, received and executed these same forms before investing in the CMO program, as did several other members of his family.[507]

247. Rubin testified that he also understood that Brookstreet's legal and compliance department had established minimum suitability standards for all CMO accounts, which he believed were being uniformly applied on a firm wide basis.[508]

248. Rubin observed that Brookstreet's legal and compliance department was very active, diligent and meticulous in conducting their ongoing suitability reviews, as well as reviewing other aspects of the CMO Program, and providing ongoing guidance and consultation to the firm's members regarding a variety of compliance issues.[509] As a result, Rubin believed that Brookstreet's legal and compliance department would help ensure that the firm's members and the CMO program as a whole stayed in full compliance with all applicable securities rules and regulations.[510]

249. Rubin testified that the firm's suitability standards and disclosure practices relating to the CMO Program were being continually reviewed, updated, formalized and improved upon over

[504] TT at 2997-98; Rubin Ex. 10a.
[505] TT at 3011, 3025; Rubin Ex. 9; SEC Ex. T-65, T-66, T-67.
[506] TT at 3011, 3019, 3025; SEC Ex. 38, 212, 213, 214.
[507] Rubin Ex. 81a.
[508] TT at 2982, 3009-11.
[509] TT at 2996-97, 3009-11, 3026, 3045, 3047-49, 3059; Rubin Ex. 9, 37, 46, 78-A; SEC Ex. 306, 384, 391, 516, 521, T-65, T-66, T-67.
[510] TT at 3049.

time by Brookstreet's legal and compliance department.[511]

250. Rubin was also aware of Brookstreet's policy that any public communications concerning the CMO program were required to be specifically reviewed and formerly approved by the legal and compliance department, and then sent to the NASD for approval, prior to their use.[512] Rubin and Kornfeld utilized two primary forms of approved advertising regarding the CMO Program: a one hour taped radio program and a newspaper advertisement entitled "Looking for Monthly Income?"[513] The taped radio program disclosed, among other things, (1) the nature and types of CMOs that were being utilized in the Program; (2) the fact that the value of the CMOs could go up or down, particularly if sold prior to maturity; and (3) that the CMOs were purchased in a block format but allocated to clients in smaller "odd lots" that were less liquid than the block.[514]

251. With respect to public advertisements concerning the CMO program, Rubin testified that he believed that Brookstreet's legal and compliance department would send any proposed advertisements directly to the NASD for their review and approval before the ad could be placed.[515] The overall form and content of these advertisements were consistent with the NASD's advertising rules and informative guidelines relating to "Communication with the Public About CMOs."[516] Rubin also knew that the NASD, in fact, reviewed the proposed CMO advertising materials and would often make corrective comments to the proposed ad, which were then incorporated by Brookstreet compliance and resubmitted to NASD for further review, comment and eventually approval.[517]

---

[511] TT at 3009-11; Rubin Ex. 9; SEC Ex. 306, 391, 516, T-65, T-66, T-67.
[512] TT at 3045, 3047-48.
[513] *Id.*
[514] TT at 3046-47; DE 355 at 113.
[515] TT at 3045, 3047-48; Rubin Ex. 37, 46; SEC Ex. 305.
[516] Rubin Ex. 37.
[517] TT at 3045, 3047-48; Rubin Ex. 37.

252. Rubin testified that he attempted to comply with Brookstreet's public communications policies, along with all of Brookstreet's other policies, practices and procedures, to the best of his ability.[518] When any potential infraction incurred, no matter how significant or insignificant, Brookstreet's legal and compliance department were quick to alert (and reprimand) the representative so that corrective action could be taken immediately.[519] As a result, Rubin believed that the firm's legal and compliance department was doing its job properly to ensure the firm's compliance with all applicable securities laws, rules and regulations.[520]

253. Around June 2006, Brookstreet's legal and compliance department updated the firm's suitability standards for the CMO Program.[521] As a result, Christensen sent e-mails to the brokers with a list of accounts that did not meet the new standards.[522] The compliance department contacted the individual representatives involved and requested that updated information be obtained from their specific customers who might be affected, to ensure that, moving forward, the clients met Brookstreet's then current suitability standards for the CMO program.[523] Some of the clients had been placed on the list because certain information concerning the individual was simply missing from Brookstreet's files; once the missing information was obtained, the clients were removed from the "unsuitable" list.[524]

254. The representatives were given a 30-day deadline to obtain the updated client information, which was to be submitted to the home office for further review and approval.[525]

---

[518] TT at 3048-49, 3099-3100.
[519] Rubin Ex. 37, 46, 78-A; SEC Ex. 21, 73, 100, 169, 250, 299, 300, 301, 305, 306, 330-A, 341, 383, 384, 391, 502, 516, 521, 563, 594-B, T-67, T-380.
[520] TT at 3049.
[521] TT at 610, 3010, 3093.
[522] TT at 596-99, 635-39, 649; SEC Ex. 21, 73, 100, 341, 383, 384, 391, 502, 516.
[523] TT at 635-39, 2832-33.
[524] TT at 635-39, 655-57.
[525] *Id.*

Those clients who could be documented as having met Brookstreet's current suitability guidelines were permitted to remain in the Program, while those who could not be were to be placed on "sell only" status.[526] Rubin attempted to comply with these directives, and noted where applicable any new information they received on "updated" account application forms.[527]

255. Then, in December 2006, the firms' legal and compliance department again revised the CMO suitability guidelines; this time, however, the new standards only applied to new CMO accounts.[528] These new suitability standards were incorporated into Brookstreet's revised Policies and Procedures Manual, dated as of January 31, 2007.[529] Additional practices and procedures concerning the CMO Program were communicated to the representatives by Brookstreet's compliance department in February, 2007.[530] In May 2007, the compliance department requested additional updated information be obtained for several additional accounts at the Coral Springs office.[531]

Rubin's Knowledge of Regulatory Exams and the Commission's 2004 Investigation

256. Rubin testified that he knew that Brookstreet operated in a regulated industry and received extensive oversight and examinations from the Commission, FINRA as well as from the firm's own internal compliance department.[532] These examinations were ongoing throughout the entire period of his employment.[533]

---

[526] *Id.*
[527] TT at 2832-33, 3093; SEC Ex. 213.
[528] SEC Ex. 306.
[529] Rubin Ex. 9; SEC Ex. T-66.
[530] SEC Ex. T-67.
[531] AR-78a.
[532] TT at 3059-61, 3191-92; Rubin Ex. 6 (¶¶45-48); SEC Ex. 521.
[533] *Id.*

257. Rubin believed the compliance examinations conducted by the Commission and FINRA were extensive and covered virtually every aspect of Brookstreet's CMO program including, among other things, reviewing: the firm's policy and procedures, customer new account opening applications, account statements, confirmations, disclosure materials, trade tickets, complaints, and advertising.[534] In connection with one such compliance examination at the Coral Springs branch office, compliance staff members from the Commission were onsite for more than three weeks reviewing the various records relating to the CMO Program.[535]

258. It was Rubin's understanding that no adverse findings or deficiency notices from the Commission or FINRA were ever issued to Brookstreet regarding any significant aspect of the CMO program at the conclusion of any of these examinations.[536]

259. Rubin was aware that in 2004, the Commission conducted an investigation captioned, "In the Matter of Certain Sales of Mortgage-Backed Securities (HO-9844)."[537] Rubin, Kornfeld and Popper were each subpoenaed to testify in Washington, D.C. in connection with that case, and ordered to produce various records concerning the CMO Program, including but not limited to, account-opening paperwork, trade tickets, buy and sell confirmations, statements, e-mails, advertising, disclosure materials and correspondence.[538]

260. Rubin understood that the scope of the Commission's 2004 investigation was very broad and encompassed Brookstreet's entire CMO program.[539] Rubin was also aware of the fact that all of the requested documents from Brookstreet's Coral Springs branch office concerning the CMO

---

[534] *Id.*
[535] TT at 2841, 3056-57, 3059-61, 3190-92, Rubin Ex. 6 ¶¶ 45-48.
[536] *Id.*; Rubin Ex. 6 (¶48).
[537] TT at 2841, 3051-54, 3188-91, 3217-18.
[538] TT at 3054, 3188-89.
[539] TT at 2841, 3051-54, 3188-91, 3217-18.

program were produced to the Commission's staff in Washington, D.C., as Rubin participated with others in the office in making that production.[540] Rubin was also aware of the fact that, in the fall of 2004, Kornfeld and Popper individually appeared for lengthy testimony at the Commission's offices in Washington, D.C., and were asked detailed questions regarding virtually all aspects of the CMO program.[541]

261. After Kornfeld's testimony in Washington, D.C., Kornfeld spoke with Rubin and, together, they contacted Brookstreet's home office to discuss, among other things, suitability issues relating to the sale of the Program CMOs to Brookstreet's retail customers.[542] Kornfeld and Rubin were again reassured by Brookstreet (and Popper) that the CMO Program, as it was being operated, was suitable for retail clients and was fully compliant with all applicable rules and regulations.[543]

262. Rubin testified that all of these events caused him to believe that the CMO program was fully vetted, not only by the Commission and FINRA, but by Brookstreet's most experienced staff, its executive management team, its legal and compliance department, as well as the firm's outside counsel.[544] As a result of these, and other facts mentioned above, Rubin believed that: (1) the CMO Program was being operated in compliance with all applicable federal securities laws, rules and regulations; (2) that all of the firm's standardized CMO risk disclosures were appropriate; (3) that Brookstreet's suitability guidelines were reasonable and appropriate and were being continually monitored and improved as time went on; and (4) that the CMO Program

---

[540] *Id.*
[541] *Id.*
[542] *Id.*
[543] *Id.*
[544] TT at 2821-22, 2841, 2853-54, 3926, 3049, 3056-57, 3190-91.

was suitable for all of Brookstreet's customers who were involved.[545]

263. Rubin testified that he sincerely believed in the CMO program, and as a result, he transferred his own retirement funds (totaling over $133,000) into the program.[546] Rubin also allowed his father to invest a total of $150,000 in the CMO Program, and his father-in-law to invest $200,000 through a margin account.[547] Rubin testified that his belief in the CMO Program was also bolstered by the fact that he knew Kornfeld's father had invested a total of $500,000 in the CMO Program on margin, and his brother-in-law had similarly invested a total of $300,000 on margin in the Program.[548] In total, Rubin was aware of the fact that, between himself, his family and Kornfeld's family, they had invested nearly $1.3 million in Brookstreet's CMO Program.[549]

264. From time to time, the pricing on certain CMOs was volatile.[550] However, Brookstreet, Popper and his team continued to represent to the brokers that the models used by the pricing service to estimate the value of the CMOs was not accurate, based on values from actual that Popper conducted.[551] Rubin understood these issues related to isolated CMOs and did not relate to the CMO Program as a whole.[552]

265. Likewise, from time to time, certain individual CMOs took longer to liquidate than Popper had represented.[553] However, throughout the life of the CMO Program, Popper was able to actively purchase and sell Program CMOs, until the collapse in the financial and housing

[545] *Id.*
[546] TT at 3012-14.
[547] Id.
[548] *Id.*
[549] *Id.*
[550] Rubin Ex. 31; SEC Ex. 279.
[551] TT at 729-30, 771-72, 1242, 1527- 28, 2822-23, 2952-56, 2995, 3004, 3042-43, 3049-50; Rubin Ex. 31.
[552] TT at 3049-50.
[553] SEC Ex. 280. SEC Ex. 280.

markets in the spring 2007.[554] Rubin believed these issues related to isolated transactions in individual CMOs and did not relate to the CMO Program as a whole.

266. Rubin continued to believe Brookstreet's CMO program was a good long-term investment even as the firm was unexpectedly shutting down in June 2007.[555] Rubin did not attempt to remove his funds from Brookstreet's CMO program prior to its demise, and two bonds in his own account were liquidated by Brookstreet without his approval or consent immediately prior to the firm's closing.[556] Rubin's father-in-law and Kornfeld's relatives lost the investments in their margin accounts.[557]

Rubin's Knowledge of CMO Performance Issues

267. At various times, questions or concerns were raised regarding the performance, safety and suitability of the CMO Program by certain Brookstreet representatives, including some of the named Defendants, and others who were not charged by the Commission.[558] Some of their questions and concerns were brought up directly to Brookstreet's executive management team, while others were brought to the attention of Brookstreet's legal and compliance department, or to Popper, or to other individuals in the Institutional Bond Group.[559]

268. After representatives and clients raised an issue regarding the pricing on certain CMOs in October 2005, Popper and the Institutional Bond Group repeatedly reassured the representatives that the pricing model being utilized to estimate the market value on the CMOs was not accurate. Popper provided specific examples of CMOs that were subsequently sold in the market for

[554] TT at 3197, 3209-11.
[555] TT at 3096-99.
[556] *Id.*
[557] *Id.*
[558] AR-21, 22, 25, 30, 31, 38, 39, 55; SEC Tr-352, 1509, T5, T867, T916.
[559] AR-21, 22, 25, 30, 31, 38, 39, 55; SEC Tr-352, 1509, T5, T867, T916.

higher prices than had previously been reported as proof of the prior pricing error.[560] As a result, the legal and compliance department prepared a form letter for the representatives to distribute to their clients in order to explain these pricing issues and to allay any concerns relating to the value of the CMO Program bonds.[561]

269. A copy of the letter was sent to all of the CMO Program customers in the Coral Springs, Florida branch office.[562]

270. Rubin testified that he did not knowingly or intentionally make any misrepresentation or omission of a material fact to an investor or prospective investor in the CMO Program, including, but not limited to, the witnesses presented against him by the Commission, Carol Scott and Alan Rogovin.

Investor Alan Rogovin[563]

271. Alan Rogovin ("Rogovin") invested approximately $100,000 in the CMO Program around August 2004.[564] Rogovin testified in his deposition that he was looking for a "relatively safe" investment that could generate a good return and income.[565] Prior to investing, Rogovin reviewed Brookstreet's website regarding the CMO Program.[566] Rogovin also received and reviewed written disclosure materials regarding the CMO program.[567] Rogovin received, read and signed the CMO Disclosure Form, which he admitted alerted him to the risks regarding the investment he was making.[568]

---

[560] AR-38.
[561] AR-39.
[562] AR-133.
[563] Video deposition transcript reviewed by the Court. *See* DE 310.
[564] Rogovin Deposition ("R. Dep") Ex. 215 (*see,* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix H).
[565] R. Dep. at 18-19.
[566] R. Dep. at 19-20.
[567] *Id.*, at 27-28.
[568] R. Dep. at 17-18.

272. Rogovin claims that he was defrauded by Rubin in connection with his investment; however, Rogovin's assertion lacks credibility in several important respects. Overall, Rogovin's memory concerning his CMO investment was extremely poor, and his testimony contradicted a sworn Declaration he had previously given to the Commission.[569] For example, in his sworn Declaration, Rogovin claimed he was retired from work as a human resources administrator, a position that does not show any investment sophistication.[570] Yet in his deposition, he testified that he had been employed for over ten years prior to his retirement as the Chief Financial Officer of Tempco Equipment Company, which generated over $10 million per year in annual revenues.[571] In that capacity, Rogovin was responsible for handling, among other things, all of the company's finances, accounting and banking activities.[572] Rogovin had also previously worked for several years as an independent business broker and small business consultant, which was also omitted from his sworn Declaration.[573]

273. Rogovin also indicated in his sworn Declaration that he did not receive information describing the CMO's or disclosing the risks associated with CMOs.[574] However, during his deposition, Rogovin admitted that he had received a green, tri-fold pamphlet on CMOs entitled "the Investor's Guide to CMOs."[575] He also initially denied in his Declaration, but admitted in his deposition, that he had signed the CMO Disclosure Form.[576]

---

[569] R. Dep. Ex. 209.
[570] R. Dep. Ex. 209 at ¶3.
[571] R. Dep at 12.
[572] *Id.*
[573] *Id.* at 13.
[574] R. Dep. Ex. 209 at ¶16.
[575] R. Dep. at 28.
[576] R. Dep. Ex. 214; R. Dep. at 17-18.

274. Based on all of the information that Rogovin provided to Brookstreet, Rubin had a reasonable basis to believe that the CMO Program was suitable for his investment needs. At the time he invested, Rogovin stated he had a net worth (excluding his home) totaling between $100,000 to $500,000; he had investable assets (including cash and securities) totaling between $100,000 - $500,000; and he had an annual income of between $25,000 and $50,000.[577] Rogovin also advised that he was seeking "income" as his primary investment objective; and that he had a "good" overall investment knowledge.[578] Rogovin's background suggested that he was a highly educated man, trained in accounting, who had been employed as the CFO of a large private corporation, and who continued to provide accounting and business consulting services to his own private clients. Accordingly, Rogovin reasonably appeared to meet Brookstreet's suitability guidelines for entry into the CMO Program as Rubin understood them in July 2004. Rogovin's application would have also been reviewed and approved by Brookstreet's compliance department, which provided a further basis for Rubin's reasonable belief that the CMO Program was suitable for Rogovin.[579]

275. Subsequently, Rogovin began taking out [redacted] per month in income from his CMO account; he later increased his withdrawals to $1,000 per month.[580] When Rogovin needed [redacted] for medical expenses, he was able to quickly withdraw those funds from his CMO account without any problems whatsoever.[581] As of August 2006, Rogovin appeared to be completely satisfied with his investment in the CMO program; at that time, Rogovin provided updated personal information to Rubin and reconfirmed his suitability and desire to remain in the

[577] R. Dep Ex. 212.
[578] *Id.*
[579] TT at 954-55.
[580] TT at 3092-95.
[581] *Id.*

CMO Program.[582]

Investor Carol Scott

276. Carol Scott ("Scott") invested approximately $126,500 in the CMO Program in about July 2005.[583] By February 28, 2007, the value of Scott's CMO account had increased to approximately $135,000.[584] After speaking with a broker from another securities firm, Scott transferred her entire account out of Brookstreet in early March 2007.[585] In the short time between February 28, 2007 and early March 2007, however, her account value had dropped to $88,000.[586]

277. Scott claimed that Rubin misrepresented certain facts to her regarding the CMO Program when she initially invested. However, Scott's recollection of these events was not reliable. Rubin testified that he did not believe he even met with Scott at the time she invested based on the fact that: (1) by July 2005, Kornfeld was conducting virtually all client meetings (particularly for clients, like Scott, who resided in Florida); and (2) only Kornfeld's handwriting (and not Rubin's) was on Scott's new account documentation and the CMO presentations materials she produced at her deposition.[587]

278. Moreover, Scott's trial testimony was contradicted by statements in her prior deposition and by various documents in her possession concerning her investment in the CMO Program.

279. For example, Scott claimed she was misled because she was not informed that her CMO account would be investing in CMOs; instead, she claimed Brookstreet only told her the

[582] TT at 2833-35, 3092-95; SEC Ex. 213.
[583] TT at 2788; SEC Ex. 450.
[584] TT at 2788; SEC Ex. 450.
[585] *Id.*
[586] DE 359 at 214.
[587] TT at 3095-96; SEC Ex. 38.

investment would involve "government-backed bonds" which promised a "risk free" return of 10-12 percent.[588] Scott admitted she knew about CMOs long before contacting Brookstreet in 2005, as her sister-in-law had gone through a "disastrous experience" after investing in CMOs during the 1990s.[589] On cross-examination, Scott ultimately admitted that the various documents she received and read from Brookstreet regarding her investment specifically disclosed that the securities involved were CMOs.[590] These included, among other things, the Investor's Guide to Collateralized Mortgage Obligations, several sample CMO confirmations, as well as Brookstreet's CMO Disclosure Form, which she had executed.[591]

280. Scott also admitted that she had listened on multiple occasions to the approved radio program that Komfeld and Rubin had aired during 2004 regarding the CMO Program.[592] Although she initially claimed the advertisement only mentioned "government backed bonds" rather than CMOs, she ultimately admitted that the radio program in fact repeatedly referred to CMOs.[593]

281. Scott also tried to portray herself at trial as being a conservative investor who had no tolerance for risk.[594] However, this characterization was contradicted by undisputed evidence admitted at trial. For example, Scott admitted that she signed and submitted documents to Brookstreet which stated she had a "moderate" (not conservative) risk tolerance, and that she was seeking "capital appreciation" (not preservation of capital or even income) as her primary

[588] TT at 2729, 2734-37.
[589] *Id.*
[590] *Id.*; TT at 2751-52; SEC Ex. 38.
[591] *Id.*
[592] TT at 2727-28.
[593] TT at 2734-37.
[594] TT at 2762-63, 2776.

investment objectives.[595] Scott received copies of these documents for her records, and also received a separate letter from Brookstreet's home office which reconfirmed her representations regarding her "moderate" risk tolerances.[596] Subsequently, Scott again reconfirmed these facts to Brookstreet a year later when her account information was updated in August 2006.[597] At that time, Scott again indicated that she had a "moderate" risk tolerance, and that her primary investment objective was growth and income.[598]

282. In addition, Scott maintained several other accounts that she utilized to invest in moderate to high risk securities, including an account at Raymond James Securities where she reflected her primary objective to be "speculation" and indicated she had a "high" risk tolerance.[599] Scott also admitted that she established another brokerage account at Scottrade where she selected her own individual stocks to purchase and sell; she also previously invested in both corporate and municipal bonds, as well as investing in several real estate projects.[600]

283. Based on her stated financial condition, risk tolerances and investment objectives, Scott reasonably appeared to meet all of the suitability standards that Brookstreet had established for investing in the CMO Program at the time she opened her account. At that time, Scott represented that she had a net worth of $1.5 million (excluding her home), an income from investments of between $50,000 to $100,000, and investable assets in excess of [redacted].[601] She was also in the highest tax bracket (over 27.5%); had a good level of investment experience, and

---

[595] SEC Ex. 38a; 32; 466.
[596] TT at 2768-69.
[597] SEC Ex. 32.
[598] *Id.*; TT at 2770-72, 2775.
[599] TT at 2736-40, 2777-87.
[600] *Id.*
[601] SEC Ex. 38a.

a relatively long (6-10 year) time horizon.[602] She further indicated that she was seeking capital appreciation as her primary investment objective.[603]

284. The Commission has offered insufficient credible evidence that Rubin made any specific misrepresentations or omissions to any investor in connection with the CMO Program. Moreover, there was absolutely no evidence presented that Rubin knew that any representations regarding the CMO Program were false or misleading, or that he intended to deceive anyone. Likewise, there was no evidence presented that Rubin acted in an unreasonable manner, let alone that he acted with gross recklessness.

285. In light of all of the facts and circumstances as Rubin understood them at the time, and the reasonable inferences that he drew from them, the Commission has not proven by a preponderance of the evidence that Rubin made any misrepresentations or omissions with the requisite scienter. Nor has the Commission proven that Rubin sold CMO securities to customers that he knew or reasonably believed were unsuitable for them. Instead, the preponderance of the evidence suggests that Rubin reasonably believed the CMO Program was suitable for Brookstreet's customers (including himself and his own family), based on all of the facts and circumstances as he reasonably understood them at the time.

Defendant Russell M. Kautz

286. Defendant Russell M. Kautz was a registered representative in Brookstreet's Medford, Orgeon office from January 2003 through June 2007.[604] In 2003, Kautz obtained a Series 24 license, which allows him to supervise other registered representatives.[605]

---

[602] *Id.*
[603] *Id.*
[604] PTS, ¶ 45 (DE 232 at 29 of 62).
[605] TT at 2050.

287. Kautz was first introduced to the CMO Program while attending Brookstreet's annual conference in May 2005. The Program was brought to Kautz's attention by another broker, Defendant Shrago, who told him that some of his customers had been in the Program for about a year, and that the Program had performed well for them - the income his clients received was around 10% on an annualized basis and the account values went up a little just about every month. He suggested that Kautz attend one of the breakout sessions that would be held at the conference by the Institutional Bond Group. Kautz attended the breakout session, as suggested.

288. The Program was described as one that would be managed by Popper, who talked about his extensive background and track history with CMO portfolios. As Kautz understood the Program, it invested only in high-quality investment grade securities, and was actively managed by Popper, who made all of the trading, allocation and liquidation decisions for all customer accounts in the Program.

289. As Kautz understood it, the CMO Program returned a better than average income stream, while Popper's active management lowered the risk to clients and provided an opportunity to diversify into an asset class that was not directly correlated to the stock market, but which could make returns in varying interest-rate environments.[606]

290. Kautz thought it sounded like a very good program for his clients who wanted income, and he liked the fact that retail clients could get institutional pricing. At the May 2005 Brookstreet annual conference, Popper told Brookstreet brokers that the CMO Program was stable because of the way he managed it.[607] Popper advised that it would take 90 days to sell a

[606] DE 358, 7 of 252.
[607] DE 357 at 110; DE 358 at 9, 11 of 252.

client's investment.[608]

291. Kautz reviewed the written materials that were handed out at the presentation and contacted Betta to learn more about the Program.[609] He also contacted a number of existing customer references.[610] He learned that Popper had a long and successful track record managing CMO investments for his clients. Based on all of the information he received, Kautz believed that it would be appropriate to recommend the CMO Program to some of his customers.

292. Previously Kautz had almost no prior knowledge or experience dealing with CMOs. Before taking the LaSalle Mastering CMOs course in 2007, Kautz's source of information on CMOs was Popper and Betta.[611]

293. Betta advised Kautz to go over the contents of the Black Folder with the client in detail, to answer any questions the client had, to discuss the eligibility requirements, to advise the client that he should expect to be in the program for a one-year period to see how it performed; and to disclose to the client the liquidity risk.[612]

294. Of his more than 300 customers, Kautz introduced the CMO Program to about 15. Nine of those customers opened CMO accounts.[613]

295. Kautz developed a practice with respect to his presentation of the CMO Program to his customers. First, he sent the Black Folder to the client and asked him or her to review it. Then he would go over the materials and disclosures in a face-to-face meeting. He filled out the account forms with his customers, and literally read each disclosure out loud, explained it, and

[608] *Id.* at 9, 11, 54.
[609] *Id.*
[610] DE 358 at 12.
[611] DE 357 at 112.
[612] DE 358 at 10.
[613] DE 358 at 12-13.

then answered, to the best of his ability, any questions that the customer had about the document. He also used the PowerPoint presentation that was provided by the Institutional Bond Group. He told his customers that he had no expertise with CMOs, and that he was recommending the CMO Program itself because of the portfolio manager, who would layer the CMOs that were appropriate for the client's investment objectives.[614]

296. Kautz did not explain to his clients that some of their CMO holdings would be interest-only CMOs.[615] He did not make this disclosure because he did not know that himself.[616] He also did not tell his clients that they would be holding odd lots that would make it difficult to sell their positions at the best price.[617]

297. Once Popper made a recommendation of a position he wanted to put clients into, the Bond Group faxed the brokers a Bloomberg description of the CMO, and a trade ticket that would list the client accounts that this position would be going into. When Kautz got this for his clients, he would call Betta and Betta would give him information that would help him explain the trade to his clients, such as what type of CMO was involved, why it was being bought now based on the interest rate environment, and what they expected it to do as far as income and appreciation. Then Kautz would call or e-mail his clients with the information, get their authorization, sign the trade ticket and fax it back to the Institutional Bond Group.[618]

298. At the Institutional Bond Group's 2006 break out session, Kautz testified that he heard Popper say that the accounts that used margin were performing a little better than accounts

---

[614] *Id.* at 15-16; DE 357 at 127.
[615] Interest-only CMOs would not pay any principal if they were held to maturity, and they are more risky compared to other CMOs because of the prepayment risk associated with them.
[616] DE 357 at 122-123.
[617] DE 357 at 123.
[618] DE 358 at 30-31, *see, e.g.*, Ex. 236.

without margin, and that the brokers should look at their client accounts to see if any were appropriate for margin "so he could layer in more CMOs into the portfolio to improve the cash flow, improve the total return picture, as well as be able to hedge against market movements in the interest rate environment. . . He wouldn't have to sell anything in order to make a quick purchase when he saw an opportunity."[619]

299. After the 2006 conference, Kautz discussed with Betta those clients he thought might benefit from being on margin. Kautz understood from Popper and Betta that using margin would make his customers' CMO accounts more stable, diverse, flexible and would generate better cash flow. Kautz had Betta explain the benefits of margin to some of his customers.[620] Kautz testified that because most of his CMO Program clients were already invested in REITs, which is considered speculative and illiquid, he did not see being on margin as any more risky because of the way that Popper managed the portfolios.[621]

300. Five of Kautz's nine customers (and Kautz himself) opened margin accounts. He met each client face-to-face and explained that he thought their account should be put on margin to improve the overall performance of the CMO portfolio, as well as allow them the opportunity to borrow from their account to take out cash when they needed. He testified that he read paragraph 10 of the CMO disclosure form to them where it stated there was no guarantee that they would not lose the equity in their account, but he said he believed that was a worst-case scenario, and based on the active management that Popper offered as the portfolio manager, he did not think that was a possibility.[622]

---

[619] *Id.* at 32-34.
[620] DE 357 at 124.
[621] Ex. 100; *Id.* at 37-39.
[622] DE 357 at 176; DE 358 at 35.

301. Kautz testified that it was his honestly held belief that Popper could mitigate the risk of being on margin by his active management and be able to move swiftly in a changing interest rate environment to take advantage of opportunities, as well as sell positions that were not performing well.[623]

302. Kautz, himself, invested $150,000 in the Program in April 2007. He was very impressed with the Program and his objectives were income to help pay for his children's college, as well as saving for retirement.[624] Kautz never made any statement to any of his clients that he believed at the time was either untrue or misleading, although now he understands that the amount of risk inherent in the Program was understated.[625]

303. Kautz testified that when he got Christensen's e-mail in the summer of 2006 about his CMO Program clients whose investment objectives were inconsistent with the firm's newly revised suitability requirements, Kautz sent these clients a letter, approved by Christensen, that told them that if they wanted to stay in the CMO Program, they would have to agree to change their investment objectives.[626] Among other things, the letter plainly stated that the client's investment objectives must include "speculation" if the client was to remain in the CMO Program. Kautz testified that without any pressure from him, his customers acknowledged and signed the form updating their financial information, objectives or risk tolerance.[627]

304. Subsequently, in about December 2006, the firms' legal and compliance department again revised the suitability guidelines, this time relating to all new CMO accounts.

305. Popper and his team continued to reassure the firm's representatives that the CMO

[623] *Id.* at 36.
[624] *Id.* at 42-43.
[625] *Id.* at 43, 63.
[626] *See* Ex. 101; DE 358 at 39-40.
[627] Ex. 101.

Program was sound and suitable for its customers, and that any pricing volatility and/or liquidity issues were only temporary occurrences within the bond market.

306. The Commission presented two witness against Kautz, Chiosso-Glass, a business owner with substantial means, and Mr. Pfohl ("Pfohl"), a retired businessman who at one time employed thirteen workers.

307. Chiosso-Glass was accompanied to her meeting with Kautz by her lawyer-son who had previously been employed by a hedge-fund manager. A year before Kautz introduced the CMO Program to her, Chiosso-Glass had rejected Kautz's proposal to invest in an annuity, real estate investment trusts and laddered CDs, because they would only provide 5-6 percent of annual yield in interest and she wanted 10 percent a year in come.[628] Chiosso-Glass was in need of additional income for her growing business needs. Chiosso-Glass testified that she knew that by seeking higher yields than what annuities, REITs and bank CDs could provide, she would have to look at other investments with a greater degree of risk.

308. Pfohl testified by deposition.[629] He had substantial investment experience, and clearly knew that all investments have risks. Even though he lost his nest-egg in the CMO Program, Pfohl only brought a claim against Brookstreet's clearing firm, NFS, and moved his account away from Kautz only after his attorney suggested that there might be an appearance of a conflict of interest which could affect his claim. When the Commission approached Pfohl as part of its investigation of Brookstreet, Pfohl turned to Kautz for advice in filling out the paperwork.

309. The Commission has alleged that Kautz made material misrepresentations and omissions to his customers. In support, it produced Chiosso-Glass and Pfohl who essentially claimed that

[628] DE 357 at 149-150, 195, 207; DE 358 at 19-21.
[629] SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix G.

Kautz failed to disclose the risks associated with the Program, and misrepresented its safety. To the extent that the Commission is relying on the witnesses' testimony about what they were or were not told, to contradict Kautz's testimony, the evidence is not credible and is contradicted by the credible testimony of Kautz. Both witnesses confirmed on cross-examination that they could not remember everything that they were told by Kautz in his description of the investment. Moreover, their testimony supports Kautz's recitation of how he had lengthy meetings with them to introduce them to the Program, and how he went over the risk disclosure documents with them in exquisite detail, answering all of their questions to the best of his ability.

310. The Commission has also asserted that it was severely reckless of Kautz to recommend securities that were extremely risky for all but the most sophisticated of investors. The Commission further contends that Kautz was severely recklessness because he failed to adequately investigate and/or understand the Program CMOs before recommending it to Brookstreet's clients.

311. Here, Kautz, as a retail registered representative, was entitled to rely upon information provided to him by his firm, its compliance department and the Institutional Bond Group. It was entirely reasonable for Kautz to believe what he heard and what he saw - that under Popper's management, a balanced portfolio could be achieved that would hedge the risks while providing a relatively stable and above-average return. The Court finds that the Commission has failed to meet its burden of establishing by a preponderance of the evidence that Kautz either knew, or it was so obvious that he must have known, that Program CMOs were inappropriately risky and complex for Brookstreet's retail customers. The preponderance of credible evidence adduced at trial establishes that Kautz was not aware of such facts, and he was not extremely reckless in

failing to know such facts. As a retail broker working for a national brokerage firm, it was entirely reasonable for Kautz to believe and rely upon the information that he received directly through the firm and its compliance department which was charged with the responsibility for overseeing the Program. Kautz invested over $100,000 of his own funds into the CMO Program, on margin. He reasonably believed from his own experience that the CMO Program was properly performing for several years as it had been explained to him. Under all of these circumstances, it cannot be said that it was an extreme departure from the standards of ordinary care for Kautz to have discussed the CMO Program with any qualified Brookstreet customer as he had been trained.

312. As soon as the CMO Program collapsed, Kautz testified that he did everything within his power to assist his CMO clients to recover their losses. And in so doing, he expressed his regrets to his customers, many of whom were like family to him. The Court, having had the opportunity to observe Kautz's demeanor while testifying has no doubt about the sincerity of his remorse for the losses suffered by his customers.

313. Only one of Kautz's nine CMO customers brought a claim against him. Most of the others followed him to his new employer, creating a strong inference that they did not believe that Kautz had misled them in any way with respect to their CMO Program accounts.

314. Kautz's behavior with respect to his recommendations to his clients did not rise to the level of reckless misconduct within the meaning of the securities laws that he is charged with violating. Kautz honestly and reasonably believed everything he told his clients concerning the Program. The Program was approved for sale by Brookstreet, his broker-dealer. Kautz read the written materials that were provided by Popper and his group. He spoke at length with Betta,

both to better understand the Program and to seek advice about the suitability of the Program for his customers. He sought out existing customer referrals to confirm their satisfaction with Popper and the Program. As Popper made buy and sell recommendations for the customer portfolios, Kautz discussed each recommendation with Betta so that he could relay information about the trade to his customers to keep them apprised of what was going on in their account. Kautz had no reason to doubt the information that he was being given. The Court finds that Kautz testified truthfully and that he did not intentionally mislead his clients. With regard to having to change their investment objectives to include speculation, he testified that he told his clients the investments were speculative, but that he considered the risk to be very low. He apologized to his CMO Program clients because he felt terrible that he had recommended an investment program that crashed.[630] Chiosso-Glass testified that she felt the apology was "very sincere."[631] The evidence does not support a finding that Kautz acted with a fraudulent intent toward any of his clients.

Defendant Shane McCann

315. Shane McCann worked at Brookstreet from July of 2002 until June 2007.[632] McCann first heard about the CMO Program after the Brookstreet conference in May of 2004.[633] Although McCann did not attend the conference, colleagues told him about it and he got the Black Folder.[634, 635] McCann spoke to Betta at least 10 times before he got involved, each time

[630] DE 357 at 188; DE 358 at 63.
[631] DE 357 at 225.
[632] TT at 2515.
[633] TT at 2516.
[634] Even though some of the pages are marked "internal broker-dealer use only," compliance told McCann that these materials were to be shared with potential clients. DE 359 at 41. McCann relied upon the information contained within the Black Folder and he did not get the impression from reading the materials that investing in the CMO Program involved a high degree of risk. DE 359 at 92-93.
[635] Ex. 207, DE 359 at 37-38, DE 361 at 54-55.

learning more about the Program.[636] Betta told him that Popper was going to buy Fannie Maes, Freddie Macs and Ginnie Maes, and that he would hedge the portfolio with interest-only and inverse floating rate CMOs. McCann testified that Betta stated that if the market rates were generally six percent, he was hoping CMOs would yield eight percent, and if the market was at seven or eight percent, the CMO Program was hoping to get 10 percent.[637] McCann understood that the Program (i) was going to be actively managed, (ii) that its investment objective was growth, income, and preservation of capital, and (iii) that it was going to use primarily AAA-rated Fannie Maes, Freddie Macs and Ginnie Maes throughout.[638] From the outset of the CMO program, it was McCann's understanding that Brookstreet only invested in agency CMOs.[639] McCann testified that the AAA ratings of the Program CMOs was an important feature when he recommended the Program to his clients. He also relied on the compliance department's statement that an investor would be suitable for the Program if their investment objective was growth and income, or appreciation.[640] Ultimately McCann had ten clients in the CMO Program; most of them were retired.[641]

316. McCann testified that Stan Brooks encouraged his representatives to sell the CMO Program to their clients by continually hosting breakout sessions, conference calls and sending e-mails to brokers to get involved with the Program.[642] McCann attended Popper's breakout session during the 2005 annual conference where Popper made a PowerPoint presentation. Based on what was presented, McCann believed that the Program was completely suitable for his

[636] TT at 2517.
[637] DE 359 at 38.
[638] DE 359 at 93.
[639] DE 359 at 81-82.
[640] DE 361 at 59, 67, 84-87; McCann Ex. 9.
[641] DE 359 at 48.
[642] DE 361 at 59.

customers, even though more than 50 percent of their portfolios were invested in inverse floaters and interest-only CMOs.[643] From June 2004 through May 2007, McCann believed that IOs and inverse floaters had similar risks to other tranches of CMOs, but that they reacted entirely differently as far as their interest rates.[644] He was never informed inverse floaters and interest-only CMOs were only suitable for clients with a high risk profile.[645]

317. McCann's clients did not sign the CMO Disclosure Form because that form was developed much later.[646] When he was asked to have his clients sign the form in the middle of 2006, McCann did not because he saw the form as Brookstreet's thinly veiled attempt to shield itself from liability.[647] Ultimately four of McCann's CMO clients signed the CMO Disclosure Form.[648]

318. McCann testified that he was never told that his clients were going to be holding odd lots; he was told that many clients would sell at the same time, which seemed reasonable to McCann so that retail clients could get the best institutional price.[649] McCann relied on Popper's recommendations and for the most part, McCann said yes to every buy and sell recommendation.[650]

Investor Warren Helgerson

319. One of McCann's first clients to invest in the CMO Program was Warren Helgerson ("Helgerson"), a retired investor who had been with McCann since 1996.[651] His investment

[643] DE 359 at 53-54.
[644] DE 359 at 43-46.
[645] DE 359 at 54-56.
[646] DE 359 at 59-60.
[647] TT at 2358-2359, 2537-2538, Ex. T44.
[648] TT at 2539; Ex. T44.
[649] DE 359 at 49.
[650] DE 359 at 51.
[651] DE 359 at 68; TT at 2547-2548; Helgerson Depo. at 11-14 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix D).

objectives were appreciation, growth and income.[652] Helgerson had been investing in tax-free bonds, municipal bonds and stocks.[653] In August of 2004, McCann recommended he sell his other investments to invest in the CMO Program.[654] McCann told Helgerson that the CMO Program was a safe and conservative investment.[655]

320. When McCann got Christensen's August 2006 e-mail with a list of unqualified CMO customers, McCann did not advise his clients to get out of the CMO Program because he believed that his clients' portfolio levels would return and increase. He did not want his clients to panic and leave the Program but rather "stay the course" and keep their long term investment objectives in mind.[656] At trial McCann introduced Exhibit 20, which shows NFS estimating the market value of Helgerson's Bank of America position at $11,413.[657] Then Helgerson called the NFS hotline for Brookstreet customers after the firm folded and sold his position for $981.[658] McCann introduced a document that he says demonstrates that the same position, if held onto, would have paid Helgerson $66,000 in income distributions between that day and the day of trial.[659] The Commission argues that McCann's assertion that Program CMOs were good investments because some of them have performed well since 2007 has no bearing on this case. "The performance of Program CMOs is not at issue. This is a case about the Defendants' misrepresentations and their failure to disclose the *riskiness* of Program CMOs. . . [I]t does not matter that some clients happened to profit because they held on to their CMOs - holding on to

[652] DE 359 at 70, DE 361 at 74.
[653] Helgerson Depo. at 26-28 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix D).
[654] DE 359 at 69.
[655] Helgerson Depo. at 28 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix D).
[656] DE 359 at 74-75.
[657] DE 361 at 69.
[658] *Id.*
[659] DE 361 at 71.

CMOs was never Popper's strategy."[660]

Investor Donald Shepard, Jr.

321. Another of McCann's clients was Donald Shepard, Jr. ("Shepard"), who had been with McCann since 1994.[661] He has a BA in mathematics, Phi Beta Kappa, and a MS in computer science.[662] He reads on average two books a week and is an avid chess player.[663] He does not watch television, but listens to NPR on the radio.[664] He has worked for different organizations, primarily writing computer code or programming.[665] He demonstrated a good knowledge of the different kinds of investment vehicles and the market.[666]

322. In 1995, he was not working and was looking for a better income stream than what he was receiving from his current investments.[667] He had an annual income of [redacted], but in 2005 he inherited about $350,000 (plus there was substantial appreciation in his other accounts). His investment objectives were income, appreciation and growth.[668] Shepard had primarily invested in mutual funds, but in 2004 McCann recommended the CMO Program because he thought it would produce more income for him.[669] The Commission is quick to point out that McCann did not tell Shepard that he would be investing in Inverse Floaters, or discuss any of the risks involved in investing in CMOs.[670] Instead, McCann presented the CMO Program to Shepard as he had been taught, as something that was supposed to have an "adequate amount of safety" but

[660] DE 343 at 47 of 88.
[661] TT at 2542.
[662] DE 359 at 3.
[663] DE 359 at 4.
[664] DE 359 at 5.
[665] DE 359 at 6.
[666] DE 359 at 7-8, 11-12.
[667] DE 358 at 197, DE 359 at 13.
[668] DE 358 at 199, 213; TT at 2426.
[669] TT at 2427-2429, 2542.
[670] TT at 2429, 2430-2431, 2443.

be able to achieve higher returns than the mutual funds he had.[671] Shepard invested about $290,000 in CMOs in August of 2004.[672] Shepard testified that he and McCann had a long term relationship, he understood the risks involved in the market, and McCann never told him any investment was completely exempt from market risk, interest rate risk, or credit risk.[673] He recalled that McCann would tell him, "past performance is no guarantee of future returns."[674]

323. Shepard testified that the CMO Program was "one of the few investments where I didn't fight with Mr. McCann, and he - - it was just, would you like to invest in some CMOs, and I said, okay. I don't recall much discussion pro or con about these things."[675] He further testified that, "[o]riginally, it was presented simply as a good way to get agency CMOs. That was my understanding of the Program. At some point, it became a riskier program and suitable only for . . . people who had a higher amount available to invest. But he still felt it was suitable for me. . . because I had experience investing in bonds and . . . bond unit funds while at McLaughlin, Piven & Vogel and other income investments."[676]

324. In March of 2007, at the recommendation of the Institutional Bond Group, McCann suggested that Shepard open a margin account.[677] McCann was told that margin accounts were doing a little better than accounts without margin.[678] Even though McCann knew that purchasing anything on margin increased risk, he did not discuss with Shepard the risks of purchasing Program CMOs on margin because he was told by the Institutional Bond Group that having a

---

[671] DE 358 at 202, DE 359 at 27, 64; TT at 2542-2543.
[672] TT at 2432; Ex. 199.
[673] DE 359 at 16-17.
[674] *Id.* at 17.
[675] DE 358 at 209.
[676] DE 358 at 210.
[677] TT at 2541; TT at 2441, 2442, 2508; Ex. 202.
[678] DE 359 at 62.

margin account for Program CMOs was not risky and would give a client's account the necessary flexibility to maximize profits.[679]

325. McCann drove seven and one-half hours from Missoula to Bellevue to bring the margin agreement to Shepard and go over it with him.[680] Shepard remembers McCann telling him that he would be paying margin interest to National Financial Services to buy additional securities.[681] Shepard read the margin agreement and he did not initially agree to it because he knew going on margin increased risk, and he wanted to make a well-thought-out decision before agreeing to it.[682] He does not think McCann discussed with him that inverse floaters and non-agency CMOs would be purchased in his account, but stated that he doesn't know "that I would totally reject" inverse floaters and non-agency CMOs either.[683]

Investor Jeffrey Stevens

326. Jeffrey Stevens ("Stevens") has owned and managed rental properties for the past 50 years.[684] Currently he has 18 rental units, but in the past has owned over 100 properties.[685] He testified that there is substantial market risk in real estate, and that he has learned to organize his business plan to go through a number of market cycles where property values have increased substantially, decreased, or remained stagnant for a considerable period of time.[686] He invested in his first IRA around 1980, has owned mutual funds, bonds, CDs, and has carried loans for investing in property.[687] He is able to give a general description of a CMO, and when he

[679] TT at 1666, 2541, 2851.
[680] DE 359 at 30.
[681] DE 359 at 30.
[682] *Id.* at 29-31.
[683] DE 358 at 214-216.
[684] DE 361 at 4.
[685] DE 361 at 6.
[686] DE 361 at 6.
[687] DE 361 at 7.

considers buying a bond he looks at the rating of the bond, the issuer, the projected rate of return, and the projected and current economic trends that might affect the value of the bond.[688] He considers himself a reasonably sophisticated investor, and is thoroughly aware that there are always risks involved and no guarantees in the financial markets.[689]

327. Stevens never had a problem saying no to one of McCann's recommendations.[690] He finds McCann's explanations well thought-out and thorough. If McCann could not answer any of his questions, McCann always researched it and got back to him and explained the answer in an understandable way.[691]

328. Stevens testified that McCann recommended the CMO Program to him to increase the long-term rate of return on his investments.[692] They went through the materials in the Black Folder together.[693] McCann explained the Program clearly to him and he understood that there would be an active portfolio manager overseeing the Program.[694] Stevens considered that as an attribute. He understood that the Program would be investing in AAA rated Fannie Maes, Ginnie Maes, and Freddie Macs, and that the portfolio manager would be using inverse floaters and interest-only securities.[695] McCann never told him this investment was like a bank CD, and never guaranteed him a return of any kind.[696] After the meeting, he, his mother and his sister invested just over one million dollars in the CMO Program.[697] They understood "that there was

[688] DE 361 at 8.
[689] DE 361 at 9, 51.
[690] DE 361 at 12.
[691] DE 361 at 13.
[692] DE 361 at 14.
[693] DE 361 at 14.
[694] DE 361 at 15.
[695] DE 361 at 15-16.
[696] DE 361 at 16.
[697] DE 361 at 16.

increased level of risk involved in this investment" and that McCann was thorough in describing that risk.[698]

329. McCann recommended margin saying it would probably increase their income by two or three percentage points.[699] He read the margin account agreement, knew he was taking on an additional level of risk, and knew he would be borrowing the money from NFS.[700]

330. In June 2004, Stevens opened two accounts and was in the Program until June of 2007.[701] He found being in the CMO Program frustrating. There were substantial valuation swings, faulty pricing, and at times no value for an entire position. The confirmations got more detailed and the confirmation and monthly statements had more disclaimers.[702] Stevens thought perhaps Brookstreet management was becoming more concerned about the viability of the Program and was trying to insulate themselves in case of problems in the future.[703]

331. Stevens lost at least one million dollars when Brookstreet failed in June of 2007. McCann came to his house and told him.[704] Stevens does not believe McCann made any misleading statements to him.[705]

332. Stevens made a claim against NFS claiming that it had improperly priced the bonds, improperly seized his assets, and sold them for pennies on the dollar.[706] He settled with NFS, his net deficit was deleted and he got approximately 64 cents on the dollar.[707] Stevens is still with

---

[698] DE 361 at 16-17.
[699] DE 361 at 18.
[700] *Id.*
[701] DE 361 at 19-20, 32-33.
[702] DE 361 at 20-21.
[703] DE 361 at 21.
[704] *Id.*
[705] *Id.*
[706] DE 361 at 26-27.
[707] DE 361 at 27-28, 31.

McCann and agrees that McCann is "methodical and aboveboard."[708]

333. As stated earlier, McCann, and all Defendants, were entitled to rely upon the information provided to them by Brookstreet, its legal and compliance department and the Institutional Bond Group team. It was entirely reasonable for McCann to believe what he heard and what he saw - that under Popper's management, a balanced portfolio could be achieved that would hedge the risks while providing a relatively stable and above-average return. The Court finds that the Commission has failed to meet its burden of establishing by a preponderance of the evidence that McCann either knew, or it was so obvious that he must have known, that Program CMOs were inappropriately risky and complex for Brookstreet's retail customers. The preponderance of credible evidence adduced at trial establishes that McCann was not aware of such facts, and he was not extremely reckless in failing to know such facts. Under all of the circumstances, it cannot be said that it was an extreme departure from the standards of ordinary care for McCann to have discussed the CMO Program with any qualified Brookstreet customer as he had been taught.

334. As soon as the CMO Program collapsed, McCann did everything within his power to assist his CMO clients to recover their losses. The Court, having had the opportunity to observe McCann's demeanor while testifying has no doubt about the sincerity of his remorse for the losses suffered by his customers.

335. The Court finds that McCann testified truthfully and that he did not intentionally mislead his clients. The evidence does not support a finding that McCann acted with a fraudulent intent toward any of his clients.

---

[708] DE 361 at 68.

Defendant Travis A. Branch

336. Branch was a registered representative and the branch manager for Brookstreet's Honolulu office from February 1995 to June 2007.[709] He holds Series 6, 7, 22, 24, and 63 securities licenses.[710]

337. After hearing Popper's presentation at Brookstreet's 2004 annual conference, Branch "talked to about half a dozen of [Popper's] references . . . to make sure that what he was saying was realistic.'"[711] Branch testified that he then invested $50,000 of his own money in the CMO Program so that he could learn about the Program from his own experience before selling it to his clients.[712, 713] He testified that his return was 26% in six months. He felt all his clients "were entitled to this." Branch testified that at the time, Brookstreet's only requirement was that an investor had to have a minimum of $100,000 to invest.[714]

338. He was very pleased with the CMO Program's performance and after meeting with Popper in Boca Raton later that year, Branch began recommending the Program to his customers.[715] He recommended the Program to about two dozen of his clients who met the eligibility requirement.[716] He told them he had invested in the Program and that he thought it was the right thing for them.[717] Branch used his own account's track record as an illustration on how well the Program performed.[718] He also tried to explain the CMO Program through a

[709] DE 358 at 67.
[710] DE 358 at 66.
[711] TT at 2364.
[712] Branch also invested a family trust account ("YTC") in the CMO Program with $900,000 in August 2004. DE 358 at 75.
[713] DE 358 at 70-71.
[714] DE 358 at 73, 142, 149-150.
[715] DE 358 at 72.
[716] DE 358 at 73-74.
[717] DE 358 at 145.
[718] DE 358 at 172.

presentation he created.[719] He testified that the presentation did not necessarily explain inverse IOs or inverse floaters because he was told many times by his clients that they could not understand what he was trying to explain.[720, 721] He testified that he also provided clients with a copy of the Investor's Guide to CMOs.[722]

339. Consistent with what he was told and what he believed, Branch recommended the CMO Program to retirees who sought stability of principal and to investors who did not have a high-risk profile.[723] Branch testified that he sincerely believed that the CMO Program was "the least risk that I could offer for the best reward for my clients."[724] He felt it was an opening to access a market that had only been available in the past to institutions. He felt he could rely on Popper and the CMO market to be less speculative and more formulaic.[725]

340. Branch told his customers everything he had been told by Popper, including that the underlying mortgages were guaranteed by the federal government, and that Popper was able to create a balanced, hedged CMO portfolio.[726] Branch testified that he believes CMOs can be safer than stocks.[727]

341. While Branch knew that Inverse Floaters and IOs were riskier and more volatile than other types of CMOs, he felt they were suitable for his CMO customers because the CMO Program maintained a diversified portfolio of different types of CMOs. Branch did not analyze the CMOs that Popper bought for his clients' funds; he relied on Popper to decide what was

[719] Ex. 599.
[720] Branch testified that he gave the same presentation to the Kiyabus that he gave to all of his clients – and that he told all his clients the same thing. TT at 2324, 2327, 2350-2366, 2396-97; Branch Ex. 1.
[721] DE 358 at 180-184.
[722] DE 358 at 173.
[723] DE 358 at 81, 83, 151.
[724] TT at 2368.
[725] TT at 2365.
[726] DE 358 at 90-91.
[727] DE 358 at 81.

suitable, and followed Popper's recommendations.[728]

342. In August of 2006, Popper encouraged brokers to have their clients invest in CMOs on margin and Branch did so.[729] Branch believed that if the "Reg T guidelines" set by Commission only allowed a stock to be margined one-to-one, but allowed agency CMOs to be margined ten-to-one, then the Commission must have considered the CMOs low risk.[730]

343. When Branch received Christensen's August 2006 email notifying him that many of his clients were unsuitable, Branch thought the e-mail was "ridculous" and "nonsense."[731] Branch felt it was unfair to his clients who did not meet the new suitability threshold but who were already in the CMO Program because they were high net worth investors who were happy with their investments in the CMO Program.[732] He called Christensen because he believed that if he liquidated their accounts, they would have gotten pennies on the dollar and their accounts would have been wiped out.[733] The accounts remained open.[734]

344. When Stephen Osiecki ("Osiecki") and his wife sold their home in Hawaii, they told Branch that they were interested in investing the proceeds from the sale of the house for their retirement.[735] Branch suggested they could invest in a certificate of deposit or in the CMO Program.[736] Osiecki testified that Branch repeatedly told them that investing with the CMO Program was "very safe" and that "the federal government would have to collapse, default . . . on

[728] DE 358 at 86, 88-90.
[729] DE 358 at 92.
[730] TT at 2362-2363.
[731] DE 358 at 105-107.
[732] DE 358 at 106.
[733] DE 358 at 108-109.
[734] DE 358 105-109.
[735] Osiecki Depo. at 12-13 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix E).
[736] Osiecki Depo. at 12-16 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix E).

its obligations in order for these to be in any way vulnerable."[737] Branch also told the Osieckis that the CMOs were AAA rated.[738] In October of 2006, Branch had the Osieckis complete a margin account application.[739] The Osieckis had never before invested on margin, and Branch never explained what a margin account was.[740] Indeed, Osiecki testified that he did not understand that he was borrowing money when he invested on margin.[741] By the time Branch recommended that the Osieckis invest in margin – in October of 2006 – Christensen had already sent Branch an e-mail stating that if an investor wanted to invest on margin, the investor's investment objective had to be speculation.[742] Despite this, Branch admitted that he never told the Osieckis that their investment objective had to be speculation if they wanted to invest on margin.[743]

345. At trial, Branch gave the Court the same presentation that he gave his clients.[744] Branch said that the Program limited the risks through hedging and active management of the account.[745] Branch also told his clients that the performance of Program CMOs was "predictable because interest rates are moved up or down to stimulate or slow down the economy."[746] This presentation was incoherent and the Commission's expert opined that it was grossly

---

[737] Osiecki Depo. at 20-22 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix E).
[738] Osiecki Depo. at 23 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix E).
[739] Osiecki Depo. at 34-35 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix E).
[740] Osiecki Depo. at 36 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix E).
[741] Osiecki Depo. at 36-37, 40-42 (*see* SEC Designation of Deposition Testimony to be Presented at Trial, DE 239, Appendix E).
[742] Ex. 594B.
[743] TT at 2338-2339; DE 378.
[744] TT at 2350-2359; Branch Ex. 1.
[745] TT at 2355.
[746] TT at 2355-2356.

misleading.[747]

346. At the time Branch received the August 2006 e-mail from Christensen, the Osieckis had not yet invested in the Program. In the fall of 2006, they initially invested $150,000 and then in March 2007, they added another $100,000.[748] When the Osieckis opened a margin account in October of 2006, Branch did not tell them that their investment objective needed to be speculation if they wanted to invest in CMOs on margin.[749] In June 2007, the Osiecki Family Trust had a negative balance of $385,000.[750] Their account listed their top two investment objectives as capital appreciation and trading profits.[751]

347. The evidence above shows Branch acted severely recklessly when he recommended to the Osieckis that they invest on margin when he knew from Christensen's August, 2006 email their investment objectives had to include speculation. The Osieckis investment objective did not include speculation.

II. CONCLUSIONS OF LAW

Section 17(a)(1) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act

Sections 17(a)(1) of the Securities Act, which proscribes fraudulent conduct in the offer or sale of securities, and Section 10(b) and Rule 10b-5 of the Exchange Act, which proscribe fraudulent conduct in connection with the purchase or sale of securities, both prohibit essentially the same type of practices. *United States v. Naftalin*, 441 U.S. 768, 773 n.4 (1979). To establish violations of these antifraud provisions, the Commission must show the Defendant: (1) made a

[747] TT 937-938.
[748] DE 358 at 109.
[749] TT at 2338-2339; DE 378.
[750] SEC Ex. 12, DE 358 at 113-114.
[751] SEC Ex. 3.

false statement or omission; (2) that was material; (3) that he acted with scienter; (4) in connection with the purchase or sale of securities; (5) while using the facilities of interstate commerce. *See SEC v. Merchant Capital, LLC*, 483 F.3d 747, 766 (11th Cir. 2007) ("*Merchant Capital*"). The Commission bears the burden of proof and must prove each of the required elements by a preponderance of the evidence. *See, SEC v. Ginsburg*, 362 F.3d 1291, 1298 (11th Cir. 2004). Liability under the anti-fraud provisions cannot attach when at least one element critical for recovery is absent. *See, Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994); *Ziemba v. Cascade Intern., Inc.*, 256 F.3d 1194, 1206 (11th Cir. 2001).

There was a lot of testimony at trial regarding the investors' suitability to invest in the CMO Program. A "suitability" claim involves allegations that a "broker knew or reasonably believed that the securities he recommended to the customer were unsuitable in light of their customers' investment objectives, but that he recommended them anyway". *Murray v. Dominick Corp. of Can.*, 117 F.R.D. 512, 516 (S.D. N.Y. 1987). A "suitability claim" is not different from any other type of securities fraud claim under Section 10(b). *Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1032 (4th Cir. 1997) ("A claim for § 10(b) suitability fraud is a subset of the ordinary § 10(b) fraud claim") (quoting *Brown v. E.F. Hutton Grp., Inc.*, 991 F.2d , 1020, 1031 (2nd Cir. 1993)). Accordingly, such a case requires that the Commission prove the critical element of scienter. *See Brown v. E.F. Hutton Group, Inc.*, 991 F.2d at 1031.

The Commission asserts that Defendants made material misstatements and omissions in connection with the sale of Program CMOs by misrepresenting to clients that:

a. Program CMOs were safe investments that were appropriate for retirement accounts,

and/or investors with conservative investment objectives, including those who indicated that preservation of capital was their main investment objective;

b. there was low or no risk to principal; and

c. the CMOs in the Program were all guaranteed by the U.S. government.

The Commission further asserts that Defendants

d. misrepresented the nature, use, or extent of margin that would be used in their clients' CMO Program accounts and/or omitted the risks of investing on margin;

e. failed to disclose to their clients key characteristics of Program CMOs, including the risks associated with these "esoteric securities;" and

f. failed to disclose that Program CMOs were only suitable for sophisticated investors with a high-risk profile.

Scienter

Scienter constitutes an important and necessary element of a § 10(b) securities fraud violation. In *Ernst & Ernst v. Hochfelder*, the Supreme Court announced that scienter is "a mental state embracing an intent to deceive, manipulate, or defraud." 425 U.S. 185, 193 n.12 (1976). A plaintiff cannot recover without proving that a defendant made a material misstatement, not merely innocently or negligently, but with *an intent to deceive. Merck & Co., Inc. v. Reynolds*, 559 U.S. 633, 649 (2010) (emphasis in original). This standard requires courts to take into account "plausible opposing inferences." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 323 (2007).

In the Eleventh Circuit Court of Appeal, scienter may be established if it is demonstrated that a defendant acted with "severe recklessness." *Magna Inv. Corp. v. John Does One Through*

Two Hundred, 931 F.2d 38, 39 (11th Cir. 1991); *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809, 814 (11th Cir. 1989) ("*McDonald*"); *White v. Sanders*, 689 F.2d 1366, 1367 n.4 (11th Cir.1982); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961 (5th Cir.) (en banc), *cert. denied*, 454 U.S. 965 (1981) ("*Rockwell*"). "Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *McDonald*, 863 F.2d at 814 (quoting *Rockwell*, 642 F.2d at 961-62); *see also, Woods v. Barnett Bank of Ft. Lauderdale*, 765 F.2d 1004, 1010 (11th Cir. 1985); *Kennedy v. Tallant*, 710 F.2d 711, 720 (11th Cir. 1983); *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied*, 435 U.S. 952 (1978). The degree of recklessness in one's disregard for the truth necessary to serve as scienter is **extremely high** and a district court's express finding that the requisite intent or recklessness was not proved is reviewable only for clear error. *Securities and Exchange Commission v. Southwest Coal & Energy Co.*, 624 F.2d 1312, 1321 (11th Cir. 1980) (emphasis added).

The Commission alternatively argues that if the Court finds that Defendants did not act with intent, then they should be found to have been severely reckless in recommending Program CMOs without adequately understanding them and continuing to recommend them in spite of being aware of several "red flags," which include extreme price fluctuations, long liquidation periods, massive margin balances, and the appearance of non-agency CMOs in their clients' accounts. The Commission argues Defendants failed to apprise their clients of key risk factors of Program CMOs, including that IOs expire without notice and that Program CMOs are only

suitable for sophisticated investors with a high-risk profile. According to the Commission, Defendants' failure to satisfy these duties when speaking about Program CMOs to unsophisticated investors, retirees, and investors with a conservative risk-profile was "an extreme departure from the standards of ordinary care." *McDonald*, 863 F.2d at 814; *Carriba Air*, 681 F.2d at 1324.

"Clients trust in investment advisers... at least for the safekeeping and accumulation of property. Bad investment advice may... lead to ruinous losses for the client. To protect investors, the Government... may require that investment advisers, like lawyers, evince the qualities of truth-speaking, honor, discretion, and fiduciary responsibility." *Wollschlaeger v. Governor of Florida*, – F.3d –, 12-14009, 2014 WL 3695296, *36 (11th Cir. July 25, 2014) quoting *Lowe v. S.E.C.,* 472 U.S. 181, 229 (1985) (White, J., concurring) (internal quotation marks omitted). But this is not to say that investment advisors cannot be wrongly advised themselves or that they do not make legitimate mistakes.

The Court finds that the evidence does not lead to the conclusion that Gagliardi, Kautz, McCann, Rubin or Shrago either knew, or it was so obvious that they must have known, that Program CMOs were inappropriately risky and complex for investors who had preservation of capital as their main objective. The Commission has offered insufficient evidence to demonstrate the level of culpability for scienter or severe recklessness as to these five Defendants. *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977) citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Smallwood v. Pearl Brewing Co.,* 489 F.2d 579 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974).

There is an abundance of evidence showing that it was *not unreasonable* for Defendants

to rely upon the expertise of Brookstreet, which at the time was a large, national firm. Brookstreet had a centralized, fully staffed and active legal and compliance department. And particularly significant, the CMO Program Manager was an experienced and knowledgeable trader who had a successful track history. Prior to Brookstreet's unexpected collapse in June 2007, Defendants reasonably relied upon Brookstreet's renowned "expert" CMO Portfolio Manager Popper, along with his "portfolio management team," to properly manage the CMO accounts. Defendants had no reason to doubt Popper's expertise or other representations regarding the CMO Program. Brookstreet, through Popper and his team, repeatedly assured the representatives that the CMO Program offered an actively managed, balanced and diversified investment opportunity, that was suitable for, among others, conservative, retail customers who sought capital preservation as their investment objective. Popper further claimed that the clients' CMO portfolios were being individually managed, using sophisticated computerized models in order to tailor the individual CMO accounts to the specific investment goals and risk profiles of each specific client (ranging from conservative to aggressive).

Everything Defendants knew about the CMO Program they learned at Brookstreet conferences, as well as through compliance approved e-mails, conference calls, informational marketing materials,[752] and information contained on Brookstreet's website. Brookstreet's endorsement of Popper and the CMO Program set the stage for Defendants' reasonable belief in Popper's expertise in trading CMOs.

During a time when there was a lot of volatility, the legal and compliance department

[752] The document What are Ginnie Maes? states that the combination of safety, yield, liquidity and monthly income are seldom found in other types of securities. The "Dear Investor" letter in the Black Folder warned of the inherent volatility associated with the high variability of prepayment speeds of the mortgages contained in the Program's portfolio.

went so far as to prepare a letter for the representatives to send to their clients which explained the recent pricing volatility to allay clients' concerns. Defendants reasonably believed what Brookstreet and Popper told them, and many Defendants demonstrated that belief by investing in the Program themselves and putting their family members in it.

The Court does not doubt that Gagliardi, Kautz, McCann, Rubin and Shrago sincerely believed what they were being told regarding the CMO Program, and in particular, that it was suitable for Brookstreet's retail clients. Gagliardi, Kautz, McCann, Rubin and Shrago understood that the firm's compliance department was reviewing the account opening information to determine suitability for all new CMO accounts before the account was approved and opened at the home office. Gagliardi, Kautz, McCann, Rubin and Shrago further understood that the CMO Program was being closely monitored by the firm's compliance and legal department, and that it had also been thoroughly investigated by the Commission without incident, and had also passed multiple compliance examinations from 2004 thorough 2007 conducted by Commission and FINRA examiners. As a result, Gagliardi, Kautz, McCann, Rubin and Shrago reasonably believed that the CMO Program complied with all applicable securities laws, rules and regulations and was suitable for Brookstreet's retail clients.[753, 754]

It was not so obvious that Popper was a master shyster that Defendants must have known he was a fraud because for a period of approximately three years, or about until late May 2007, the Program performed as predicted. Over time, as elaborated upon above, Brookstreet made changes to investor suitability requirements. While employed at Brookstreet, Defendants

[753] The document Institutional Mortgage Backed Bonds, created by Brookstreet and included in the Black Folder, states that a high level of return with capital preservation may be achieved by investing in the CMO Program.
[754] The Investor's Guide to CMOs states that liquidity can vary widely and discusses the risk of prepayment.

observed how the firm's existing policies, practices and procedures regarding the CMO Program were being continually reviewed, updated, formalized and improved upon by Brookstreet's legal and compliance department.

In light of all the above, it was not an extreme departure from the standards of ordinary care for Gagliardi, Kautz, McCann, Rubin and Shrago to recommend investing in the CMO Program. Gagliardi, Kautz, McCann, Rubin and Shrago did not knowingly or intentionally make misrepresentations or omissions of a material fact to an investor or prospective investor in the CMO Program. And all red flags were consistently and logically explained away by Popper and his team, with the support of the Compliance Department. The flaws in the Program that made it unsuitable for retail investors were not so obvious that Gagliardi, Kautz, McCann, Rubin and Shrago were severely reckless in recommending the Program to unsophisticated investors or retirees. Therefore, Gagliardi's, Kautz's, McCann's, Rubin's and Shrago's recommendations to invest in the CMO Program were made in good faith and they had a reasonable basis to make those recommendations when made.

On the other hand, the Court finds that Betta and Branch acted with scienter because they made highly unreasonable omissions or misrepresentations that involved an extreme departure from the standards of ordinary care, and mislead investors which was either known to Betta and Branch or was so obvious that Betta and Branch must have been aware of it. *Magna Inv. Corp. v. John Does One Through Two Hundred*, 931 F.2d 38, 39 (11th Cir. 1991); *McDonald*, 863 F.2d at 814.

Betta's main role was to ensure that brokers and their clients properly understood the CMO Program. Betta omitted to state material facts, failed to make full and fair disclosures, and

made misleading statements about material facts when speaking about Program CMOs to brokers, unsophisticated investors, retirees, and investors with a conservative risk-profile. Betta perpetrated Popper's lie that CMO allocation recommendations were based on computer models and other scientific methodology when he knew that it was based merely on who's account had cash to make a purchase. Betta failed to disclose to the investors he spoke with and to the brokers who relied upon him, key characteristics of Program CMOs, including the risks associated with these esoteric securities. Betta was severely reckless when he recommended Program CMOs to brokers and unsophisticated investors with conservative risk tolerances despite knowing that they were risky, illiquid securities. Betta understood that investing in IOs was not consistent with an investment objective of capital preservation, yet he distributed materials to brokers indicating that the CMO Program was operated in a manner consistent with capital preservation. In mid- to late- 2005, he also knew that non-agency CMOs were purchased for customers' accounts and that this type of CMO was not suitable for the accounts of customers seeking capital preservation. Despite this knowledge, he continued sending out the same materials that represented that only agency CMOs would be purchased even though non-agency CMOs made up about 10% of the Program.

He also misrepresented the nature, use or extent of margin that would be used in investors' CMO Program accounts. He recklessly encouraged and promoted the use of margin for many investors, wrongfully telling brokers and brokers' investors that using margin would make the customers' CMO accounts more stable, diverse, flexible and generate better cash flow. Betta mislead the brokers and their customers that there never had been and never would be a margin call, and that having CMOs on margin was like having treasuries on margin. He knew

margin was only appropriate for investors whose investment objective was speculation but he opened margin accounts for investors who did not seek speculative investments. These acts constitute "an extreme departure from the standards of ordinary care," and he has violated the federal securities laws.

Before recommending Program CMOs to his clients, Branch knew that the CMO Program traded Inverse Floaters and IOs and that these investments were risky. Nonetheless, because he believed they were properly hedged, Branch told his clients that there was no way they could lose money with the CMO Program. When Branch received Christensen's August 2006 email notifying him that many of his clients were unsuitable, Branch thought the e-mail was "ridculous" and "nonsense."[755]

When Branch got his clients, the Osieckis, to invest on margin, Christensen had already sent Branch an e-mail stating that if an investor wanted to invest on margin, the investor's investment objective must include speculation.[756] Despite this, Branch admitted that he never told the Osieckis that their investment objective had to be changed to speculation if they wanted to invest on margin. This was severely reckless conduct and meets the standard for scienter.

INJUNCTIVE RELIEF

The extent to which the Commission has to prove scienter in an injunctive action appears to depend on the specific section of the securities laws being relied upon. The Supreme Court in *Aaron v. SEC*, 446 U.S. 680 (1980) ("*Aaron*"), held that the plain meaning of the words of Section 10(b) compelled it to conclude that the Commission must establish "scienter" in an

[755] DE 358 at 105-107.
[756] SEC Ex. 594B.

injunctive action based on violations of Rule 10b-5.[757]

The first clause of Section 17(a), like Section 10(b) and Rule 10b-5, requires proof of scienter since it uses the terms "device," "scheme," and "artifice," all of which, to the Court, "connote knowing or intentional practices."[758] The second clause of Section 17(a), however, merely makes untrue or misleading statements unlawful, and "is devoid of any suggestion of a scienter requirement."[759] The third clause, which refers to "transactions or practices which *operates or would operate* as a fraud or deceit" [emphasis added by the Court] upon the purchaser, "focuses upon the effect of particular conduct ... rather than upon the culpability of the persons responsible."[760] Accordingly, the Commission must show scienter to obtain an injunction under § 17(a)(1) or any part of 10b-5.[761] Because the Commission must show some likelihood of a future violation,[762] Defendants whose past actions have been in good faith are not likely to be enjoined.

In a concurring opinion, Chief Justice Burger asserted that because of the requirement in injunctive proceedings of a showing that there is a reasonable likelihood that the wrong will be repeated, the Commission "will almost always" be required to prove that the defendant's prior conduct was more culpable than negligence.[763] The majority opinion does not go this far, but does refer to "scienter" or a "lack of it" as an important consideration in determining whether or

---

[757] *Aaron*, 446 U.S. at 701 ("when scienter is an element of the substantive violation sought to be enjoined, it must be proved before an injunction may issue").
[758] *Aaron,* 446 U.S. at 696.
[759] *Id.*
[760] *Id.* at 697.
[761] Hence, the presence or lack of scienter constitutes "one of the aggravating or mitigating factors to be taken into account" in the exercise of a court's equitable jurisdiction. *Aaron*, 446 U.S. at 701.
[762] The Commission is entitled to injunctive relief when it establishes (1) a prima facie case of previous violations of federal securities laws, and (2) a reasonable likelihood that the wrong will be repeated. *S.E.C. v. Calvo*, 378 F.3d 1211, 1216 (11th Cir. 2004) citing *SEC v. Unique Fin. Concepts, Inc.*, 196 F.3d 1195, 1199 n.2 (11th Cir. 1999).
[763] *Aaron,* 446 U.S. at 703.

not an injunction should be issued.[764] The Chief Justice concluded that "[a]n injunction is a drastic remedy, not a mild prophylactic, and should not be obtained against one acting in good faith."[765]

NEGLIGENCE

While scienter is required to establish violations of § 17(a)(1) of the Securities Act and § 10(b) and Rule 10b-5 of the Exchange Act, it is not required to establish a violation of §§ 17(a)(2) or 17(a)(3) of the Securities Act. A finding of mere negligence is sufficient.[766]

At trial, and in its Amended Proposed Findings of Fact and Conclusions of Law,[767] the Commission argued that even if the Court finds that Defendants did not act with scienter, they most certainly acted with negligence and thus, at a minimum, violated Sections 17(a)(2) and (3) of the Securities Act. The Commission cites as evidence the fact that many Defendants recommended Program CMOs to clients without studying them sufficiently to become informed

---

[764] *Aaron*, 446 U.S. at 701.
[765] *Aaron,* 446 U.S. at 703.
[766] *Aaron*, 446 U.S. at 697. While the Supreme Court decided that scienter was a necessary prerequisite under the 1934 Act, its response split with respect to §17(a):

> The language of §17(a) strongly suggests that Congress contemplated a scienter requirement under §17(a)(1), but not under §17(a)(2) or §17(a)(3). The language of §17(a)(1), which makes it unlawful "to employ any device, scheme, or artifice to defraud," plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct....
>
> By contrast, the language of §17(a)(2), which prohibits any person from obtaining money or property "by means of any untrue statement of a material fact," is devoid of any suggestion whatsoever of a scienter requirement....
>
> Finally, the language of §17(a)(3), under which it is unlawful for any person "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit," quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible....

Aaron, 446 U.S. at 695-97.
[767] DE 344, ¶ 24.

as to their nature, price and financial prognosis.[768] The Commission also argues that the disclaimers that were made were not transmitted with the degree of intensity and credibility sufficient to effectively counterbalance any misleading impressions created by the brokers' representations.

Many of the Defendants balk at the Commission's newly asserted negligence claim. The Complaint, which was never amended, only alleges violations of § 17(a) without specifying which subsection the Complaint was targeting. However, the Complaint specifically asserts that Defendants committed the violations knowingly or recklessly. There is no allegation as to simple negligence. Defendants object to the addition of this last minute claim and change in Plaintiff's theory of their case. Simple negligence was neither alleged in the Complaint, nor argued in any of the three motions for summary judgment brought by the Commission, or in the Commissions' closing brief after the trial.[769] Importantly, the Commission never moved to amend the Complaint to conform to the evidence to assert a negligence claim under §§ 17(a)(2) or 17(a)(3) of the Securities Act, which should have been done if the Commission wanted to proceed on simple negligence. The Defendants did not consent at trial to this additional charge, and they would be seriously prejudiced if the Court were to consider a simple negligence claim long after discovery has closed. The Court will therefore not consider any claim that any Defendant negligently violated §17(a) of the Securities Act.

---

[768] A broker also has a "duty to recommend [an investment] only after studying it sufficiently to become informed as to its nature, price, and financial prognosis." *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987). And he or she has "the duty to inform... client[s] of the risks involved in purchasing or selling a particular security." *Id.*

[769] DE 343.

Conclusion

For the reasons set forth above, the Court denies all the Commission's requested relief against Gagliardi, Kautz, McCann, Rubin and Shrago and they are exonerated of the allegations made in the Complaint.

Betta and Branch are found to have violated the anti-fraud provisions of the Securities Act and the Exchange Act. Accordingly, it is hereby

ORDERED AND ADJUDGED that the Commission shall take nothing from Defendants Gagliardi, Kautz, McCann, Rubin and Shrago.

Betta and Branch are permanently restrained and enjoined from violating, directly or indirectly, § 10(b) of the Securities Exchange Act o 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, by using any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with the purchase or sale of any security;

(A) to employ any device, scheme, or artifice to defraud;

(B) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(C) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

It is further **ORDERED AND ADJUDGED** that

Branch is liable for disgorgement of the commissions earned from the Osiecki's account for the period while the account was on margin, together with prejudgment interest as of the date

of the filing of the complaint. There is insufficient evidence in the record for the Court to determine this amount. The Court retains jurisdiction to conduct further proceedings to determine the amount of commissions Branch earned from the Osiecki's account while their account was on margin. The Court exercises its discretion to not impose a civil penalty against Branch.

Betta is liable for disgorgement of an amount to be determined after additional proceedings, together with prejudgment interest as of the date of the filing of the complaint. The Court does not find that Betta should be required to disgorge all commissions he earned from the CMO Program. A more refined determination of the amount of his liability for disgorgement is necessary. The Court retains jurisdiction to conduct further proceedings to determine that amount. The Court exercises its discretion to not impose a civil penalty against Betta.

DONE AND ORDERED in chambers in West Palm Beach, Palm Beach County, this 29th day of March, 2018.

KENNETH A. MARRA
United States District Judge

EXHIBIT 4

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 84199 / September 19, 2018

INVESTMENT ADVISERS ACT OF 1940
Release No. 5039 / September 19, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18791

In the Matter of **TRAVIS A. BRANCH,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS 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 proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Travis A. Branch ("Respondent" or "Branch").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Travis A. Branch, age 63, resides in Kailua, Hawaii. Branch was a registered representative in the Honolulu, Hawaii office of Brookstreet Securities Corp. ("Brookstreet") from February 1995 to June 2007. He holds Series 6, 7, 22, 24, and 63 securities licenses. Branch sells insurance and performs tax consulting through his private company.

B. CIVIL INJUNCTION

2. On August 7, 2018, the U.S. District Court for the Southern District of Florida entered an amended final judgment against Branch, permanently enjoining him from future

violations, direct or indirect, of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. William Betta, Jr., et al., Civil Action Number 09-80803-CIV-MARRA (S.D. Fla.)

3. The Commission's complaint alleged, in substance, that between January 2004 and June 2007, Brookstreet sponsored the "CMO Program" through which its customers could invest in "collateralized mortgage obligations," or "CMOs." A CMO is a security that is collateralized by mortgage-backed securities, which in turn are undivided interests in a pool of mortgages. The complaint alleges that Brookstreet's CMO Program was run by its "Institutional Bond Group," located in Brookstreet's Boca Raton, Florida office, and all CMO trades at Brookstreet were funneled through the Institutional Bond Group. The Institutional Bond Group solicited Brookstreet registered representatives, including Branch, to have their customers participate in the CMO Program through Brookstreet-sponsored annual product marketing conference, Brookstreet-distributed emails, and registered representative conference calls. The complaint alleged that Branch and other Brookstreet registered representatives made false and misleading statements to their customers that the CMOs traded in the CMO Program were safe and secure investments that would produce consistent income. Beginning in early 2007, the CMO market began to fail, resulting in significant losses for all CMO Program customers and margin calls for customers on margin. As a result, many customers ended up losing their investments, and margined customers owed Brookstreet's clearing firm hundreds of thousands of dollars. The complaint alleged that by engaging in this conduct, Branch violated Section 17(a) of the Securities Act of 1933 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 proceedings be instituted to determine:

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers 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 at a time and place to be fixed by further order of the Commission, pursuant to Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent 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(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

IT IS FURTHER ORDERED that the Division of Enforcement and Respondent shall conduct a prehearing conference pursuant to Rule 221 of the Commission's Rules of Practice, 17 C.F.R. § 201.221, within fourteen (14) days of service of the Answer. The parties may meet in person or participate by telephone or other remote means; following the conference, they shall file a statement with the Office of the Secretary advising the Commission of any agreements reached at said conference. If a prehearing conference was not held, a statement shall be filed with the Office of the Secretary advising the Commission of that fact and of the efforts made to meet and confer.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, Respondent 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 Respondent as provided for in the Commission's Rules of Practice.

Attention is called to Rule 151(b) and (c) of the Commission's Rules of Practice, 17 C.F.R. § 201.151(b) and (c), providing that when, as here, a proceeding is set before the Commission, all papers (including those listed in the following paragraph) shall be filed with the Office of the Secretary and all motions, objections, or applications will be decided by the Commission. The Commission requests that an electronic courtesy copy of each filing should be emailed to APfilings@sec.gov in PDF text-searchable format. Any exhibits should be sent as separate attachments, not a combined PDF.

The Commission finds that it would serve the interests of justice and not result in prejudice to any party to provide, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), that notwithstanding any contrary reference in the Rules of Practice to filing with or disposition by a hearing officer, all filings, including those under Rules 210, 221, 222, 230, 231, 232, 233, and 250 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.210, 221, 222, 230, 231, 232, 233, and 250, shall be directed to and, as appropriate, decided by the Commission, and that any dispositive motion shall be filed under Rule 250(a) or (b).

The Commission finds that it would serve the interests of justice and not result in prejudice to any party to provide, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), that the Commission shall issue a decision on the basis of the record in this proceeding, which shall consist of the items listed at Rule 350(a) of the Commission's Rules of Practice, 17 C.F.R. § 201.350(a), and any other document or item filed with the Office of the Secretary and accepted into the record by the Commission. The provisions of Rule 351 of the Commission's Rules of Practice, 17 C.F.R. § 201.351, relating to preparation and certification of

a record index by the Office of the Secretary or the hearing officer are not applicable to this proceeding.

The Commission will issue a final order resolving the proceeding after one of the following: (A) the completion of post-hearing briefing in a proceeding where the public hearing has been completed; (B) the completion of briefing on a motion for a ruling on the pleadings or a motion for summary disposition pursuant to Rule 250 of the Commission's Rules of Practice, 17 C.F.R. § 201.250, where the Commission has determined that no public hearing is necessary; or (C) the determination that a party is deemed to be in default under Rule 155 of the Commission's Rules of Practice, 17 C.F.R. § 201.155, and no public hearing is necessary.

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.

For the Commission, by its Secretary, pursuant to delegated authority.

Brent J. Fields
Secretary

EXHIBIT 5

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 85833 / May 10, 2019

Admin. Proc. File No. 3-18791

In the Matter of

TRAVIS A. BRANCH

ORDER REGARDING SERVICE

On September 19, 2018, the Securities and Exchange Commission issued an order instituting administrative proceedings ("OIP") against Travis A. Branch pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940.[1] Counsel for the Division of Enforcement filed a notice of appearance on October 5, 2018, but no other filings have been made in this proceeding, including as to whether the OIP was served upon Branch. Accordingly, IT IS ORDERED that the Division of Enforcement file a status report concerning service of the OIP by May 24, 2019, and every 28 days thereafter until service is accomplished.

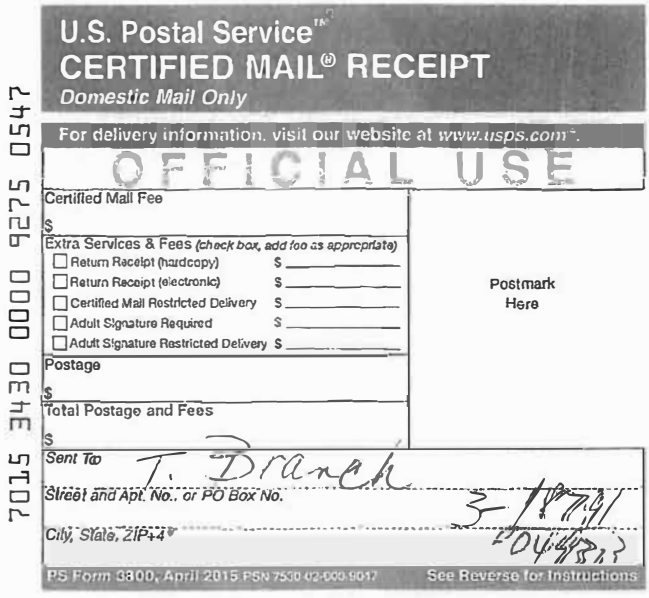
The parties are reminded that an electronic courtesy copy of each filing should be emailed to APFilings@sec.gov in PDF text-searchable format.

For the Commission, by the Office of the General Counsel, pursuant to delegated authority.

Vanessa A. Countryman
Acting Secretary

By: Jill M. Peterson
Assistant Secretary

[1] *Travis A. Branch*, Exchange Act Release No. 84199, 2018 WL 4488873 (Sept. 19, 2018); *see* 15 U.S.C. §§ 78o(b), 80b-3(f).



U.S. Postal Service™
CERTIFIED MAIL® RECEIPT
Domestic Mail Only

For delivery information, visit our website at www.usps.com®.

OFFICIAL USE

Certified Mail Fee
$

Extra Services & Fees (check box, add fee as appropriate)
- ☐ Return Receipt (hardcopy) $
- ☐ Return Receipt (electronic) $
- ☐ Certified Mail Restricted Delivery $
- ☐ Adult Signature Required $
- ☐ Adult Signature Restricted Delivery $

Postage
$

Total Postage and Fees
$

Postmark Here

Sent To T. Branch

Street and Apt. No., or PO Box No. 3 1871

City, State, ZIP+4® 20648-3

PS Form 3800, April 2015 PSN 7530-02-000-9047 See Reverse for Instructions

7015 3430 0000 9275 0547

EXHIBIT 6

HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-18791

In the Matter of **Travis A. Branch,** **Respondent.**	**STATUS REPORT REGARDING SERVICE THE ORDER INSTITUTING PROCEEDINGS**

I.e Statement of Current Statuse

The Division of Enforcement ("Division") hereby files this Status Report regardinge its service of the Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of1940 and Notice of Hearing ("OIP") on Travis A. Branch ("Respondent"). The OIP was issued on September 19, 2018 and sent to Respondent on or about September 19, 2018, at his known mailing address: 44-672 Kahinani Place No. 11, Kaneohe, Hawaii 96744. On September 27, 2018, Respondent acknowledged receiving the OIP by signing a Return Receipt that was returned to the Division on or about October 5, 2018 and is attached hereto as Exhibit 1. Respondent has not filed an answer to the OIP and has had no further written communication with the Division.

DATED: May 24, 2019

Respectfully Submitted,
DIVISION OF ENFORCEMENT
By its Attorneys:

Amy J. Longo
Douglas Miller
Securities and Exchange Commission

EXHIBIT 1

ER: COMPLETE THIS SECTION

mplete items 1, 2, and 3.
our name and address on the reverse
that we can return the card to you.
ach this card to the back of the mailpiece,
on the front if space permits.
icle Addressed to:

Mr. Travis A. Branch
14-672 Kahinani Pl # 11
Kaneohe, HI 96744

COMPLETE THIS SECTION ON DELIVERY

A. Signature
X
☐ Agent
☐ Addressee

B. Received by (Printed Name) L C Branch
C. Date of Delivery 9-27-18

D. Is delivery address different from item 1? ☐ Yes
If YES, enter delivery address below: ☐ No

3- 18791

804505

9590 9402 3849 7227 3932 66

☐ Certified Mail Restricted Delivery
☐ Collect on Delivery
☐ Collect on Delivery Restricted Delivery
☐ Insured Mail
☐ Restricted Delivery

☐ Priority Mail Express®
☐ Registered Mail™
☐ Registered Mail Restricted Delivery
☐ Return Receipt for Merchandise
☐ Signature Confirmation™
☐ Signature Confirmation Restricted Delivery

Article Number (Transfer from service label)
7017 2400 0000 0836 4554

Form 3811, July 2015 PSN 7530-02-000-9053

Domestic Return Receipt

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-18791

In the Matter of Travis A. Branch **Respondent.**

CERTIFICATE OF SERVICE

Douglas Miller, an attorney, hereby certifies that on May 24, 2019 caused a true and correct copy of **STATUS REPORT REGARDING SERVICE OF THE ORDER INSTITUTING PROCEEDINS** to be served on the following via UPS Next Day Air:

Mr. Travis A. Branch, *pro se*
[redacted] No. [redacted]
Kaneohe, Hawaii [redacted]

Dated: May 24, 2019

/s/ Douglas Miller
Douglas Miller
Division of Enforcement
Securities and Exchange Commission
Los Angeles Regional Office
444 South Flower Street, Suite 900
Los Angeles, California 90071

EXHIBIT 7

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 85970 / May 30, 2019

Admin. Proc. File No. 3-18791

In the Matter of

TRAVIS A. BRANCH

ORDER TO SHOW CAUSE

On September 19, 2018, the Securities and Exchange Commission issued an order instituting administrative proceedings ("OIP") against Travis A. Branch pursuant to Section 15(b) of the Securities Exchange Act of 1934.[1] On May 10, 2019, we issued an order directing the Division of Enforcement to file a status report concerning service of the OIP.[2] On May 28, 2019, the Division filed a status report evidencing that service of the OIP was made on Branch on September 27, 2018, pursuant to Rule 141(a)(2)(i) of the Commission's Rules of Practice.[3]

As stated in the OIP, Branch's answer was required to be filed within 20 days of service of the OIP.[4] As of the date of this order, Bryant has not filed an answer. The prehearing conference and the hearing are thus continued indefinitely.

Accordingly, Branch is ORDERED to SHOW CAUSE by June 13, 2019, why he should not be deemed to be in default and why this proceeding should not be determined against him due to his failure to file an answer and to otherwise defend this proceeding. When a party defaults, the allegations in the OIP will be deemed to be true and the Commission may determine the proceeding against that party upon consideration of the record without holding a public hearing.[5] The OIP informed Branch that a failure to file an answer could result in his being deemed in default and the proceedings determined against him.[6]

---

1 *Travis A. Branch*, Exchange Act Release No. 84199, 2018 WL 4488873 (Sept. 19, 2018).

2 *Travis A. Branch*, Exchange Act Release No. 85833, 2019 WL 2071384 (May 10, 2019).

3 Rule of Practice 141(a)(2)(i), 17 C.F.R. § 201.141(a)(2)(i).

4 *Branch*, 2018 WL 4488873, at *2; *see* Rules of Practice 151(a), 160(b), 220(b), 17 C.F.R. §§ 201.151(a), .160(b), .220(b).

5 Rules of Practice 155, 180, 17 C.F.R. § 201.155, .180.

6 *Branch*, 2018 WL 4488873, at *2.

If Branch files a response to this order to show cause, the Division may file a reply within 14 days after its service. If Branch does not file a response, the Division shall file a motion for default and other relief by July 11, 2019. The motion for default and other relief may be accompanied by additional evidence pertinent to the Commission's individualized assessment of whether the requested relief is appropriate and in the public interest.[7] The parties may file opposition and reply briefs within the deadlines provided by the Rules of Practice.[8] The failure to timely oppose a dispositive motion is itself a basis for a finding of default;[9] it may result in the determination of particular claims, or the proceeding as a whole, adversely to the non-moving party and may be deemed a forfeiture of arguments that could have been raised at that time.[10]

The parties are reminded that an electronic courtesy copy of each filing should be emailed to APFilings@sec.gov in PDF text-searchable format. Any exhibits should be sent as separate attachments, not a combined PDF.

Upon review of the filings in response to this order, the Commission will either direct further proceedings by subsequent order or issue a final order resolving the matter.

For the Commission, by the Office of the General Counsel, pursuant to delegated authority.

Vanessa A. Countryman
Acting Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

---

[7] *See generally Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012) (requiring "meaningful explanation for imposing sanctions"); *McCarthy v. SEC*, 406 F.3d 179, 190 (D.C. Cir. 2005) ("each case must be considered on its own facts"); *Gary McDuff*, Exchange Act Release No. 74803, 2015 WL 1873119, at *1 (Apr. 23, 2015); *Ross Mandell*, Exchange Act Release No. 71668, 2014 WL 907416, at *2 (Mar. 7, 2014), *vacated in part on other grounds*, Exchange Act Release No. 77935, 2016 WL 3030883 (May 26, 2016); *Don Warner Reinhard*, Exchange Act Release No. 61506, 2010 WL 421305, at *3-4 (Feb. 4, 2010), *appeal after remand*, Exchange Act Release No. 63720, 2011 WL 121451, at *5-8 (Jan. 14, 2011).

[8] *See* Rules of Practice 154, 160, 17 C.F.R. §§ 201.154, .160.

[9] *See* Rules of Practice 155(a)(2), 180(c), 17 C.F.R. §§ 201.155(a)(2), .180(c); *see, e.g.*, *Benham Halali*, Exchange Act Release No. 79722, 2017 WL 24498, at *3 n.12 (Jan. 3, 2017).

[10] *See, e.g.*, *McBarron Capital LLC*, Exchange Act Release No. 81789, 2017 WL 4350655, at *3-5 (Sep. 29, 2017); *Bennett Grp. Fin. Servs., LLC*, Exchange Act Release No. 80347, 2017 WL 1176053, at *2-3 (Mar. 30, 2017); *Apollo Publ'n Corp.*, Securities Act Release No. 8678, 2006 WL 985307, at *1 n.6 (Apr. 13, 2006).

7017 2400 0000 0833 5707

U.S. Postal Service™
CERTIFIED MAIL® RECEIPT
Domestic Mail Only

For delivery information, visit our website at www.usps.com®

OFFICIAL USE

Certified Mail Fee
$

Extra Services & Fees (check box, add fee as appropriate)
- ☐ Return Receipt (hardcopy) $
- ☐ Return Receipt (electronic) $
- ☐ Certified Mail Restricted Delivery $
- ☐ Adult Signature Required $
- ☐ Adult Signature Restricted Delivery $

Postage
$

Total Postage and Fees
$

Sent To
Travis A. Brandt

Street and Apt. No., or PO Box No.
3-1771

City, State, ZIP+4®
Bx, TX 77704

PS Form 3800, April 2015 PSN 7530-02-000-9047 See Reverse for Instructions

Postmark Here

EXHIBIT 8

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 85970 / May 30, 2019

Admin. Proc. File No. 3-18791

In the Matter of

TRAVIS A. BRANCH

ORDER TO SHOW CAUSE

On September 19, 2018, the Securities and Exchange Commission issued an order instituting administrative proceedings ("OIP") against Travis A. Branch pursuant to Section 15(b) of the Securities Exchange Act of 1934.[1] On May 10, 2019, we issued an order directing the Division of Enforcement to file a status report concerning service of the OIP.[2] On May 28, 2019, the Division filed a status report evidencing that service of the OIP was made on Branch on September 27, 2018, pursuant to Rule 141(a)(2)(i) of the Commission's Rules of Practice.[3]

As stated in the OIP, Branch's answer was required to be filed within 20 days of service of the OIP.[4] As of the date of this order, Bryant has not filed an answer. The prehearing conference and the hearing are thus continued indefinitely.

Accordingly, Branch is ORDERED to SHOW CAUSE by June 13, 2019, why he should not be deemed to be in default and why this proceeding should not be determined against him due to his failure to file an answer and to otherwise defend this proceeding. When a party defaults, the allegations in the OIP will be deemed to be true and the Commission may determine the proceeding against that party upon consideration of the record without holding a public hearing.[5] The OIP informed Branch that a failure to file an answer could result in his being deemed in default and the proceedings determined against him.[6]

---

1 *Travis A. Branch*, Exchange Act Release No. 84199, 2018 WL 4488873 (Sept. 19, 2018).

2 *Travis A. Branch*, Exchange Act Release No. 85833, 2019 WL 2071384 (May 10, 2019).

3 Rule of Practice 141(a)(2)(i), 17 C.F.R. § 201.141(a)(2)(i).

4 *Branch*, 2018 WL 4488873, at *2; *see* Rules of Practice 151(a), 160(b), 220(b), 17 C.F.R. §§ 201.151(a), .160(b), .220(b).d

5 Rules of Practice 155, 180, 17 C.F.R. § 201.155, .180.

6 *Branch*, 2018 WL 4488873, at *2.

If Branch files a response to this order to show cause, the Division may file a reply within 14 days after its service. If Branch does not file a response, the Division shall file a motion for default and other relief by July 11, 2019. The motion for default and other relief may be accompanied by additional evidence pertinent to the Commission's individualized assessment of whether the requested relief is appropriate and in the public interest.[7] The parties may file opposition and reply briefs within the deadlines provided by the Rules of Practice.[8] The failure to timely oppose a dispositive motion is itself a basis for a finding of default;[9] it may result in the determination of particular claims, or the proceeding as a whole, adversely to the non-moving party and may be deemed a forfeiture of arguments that could have been raised at that time.[10]

The parties are reminded that an electronic courtesy copy of each filing should be emailed to APFilings@sec.gov in PDF text-searchable format. Any exhibits should be sent as separate attachments, not a combined PDF.

Upon review of the filings in response to this order, the Commission will either direct further proceedings by subsequent order or issue a final order resolving the matter.

For the Commission, by the Office of the General Counsel, pursuant to delegated authority.

Vanessa A. Countryman
Acting Secretary

---

[7] *See generally Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012) (requiring "meaningful explanation for imposing sanctions"); *McCarthy v. SEC*, 406 F.3d 179, 190 (D.C. Cir. 2005) ("each case must be considered on its own facts"); *Gary McDuff*, Exchange Act Release No. 74803, 2015 WL 1873119, at *1 (Apr. 23, 2015); *Ross Mandell*, Exchange Act Release No. 71668, 2014 WL 907416, at *2 (Mar. 7, 2014), *vacated in part on other grounds*, Exchange Act Release No. 77935, 2016 WL 3030883 (May 26, 2016); *Don Warner Reinhard*, Exchange Act Release No. 61506, 2010 WL 421305, at *3-4 (Feb. 4, 2010), *appeal after remand*, Exchange Act Release No. 63720, 2011 WL 121451, at *5-8 (Jan. 14, 2011).

[8] *See* Rules of Practice 154, 160, 17 C.F.R. §§ 201.154, .160.

[9] *See* Rules of Practice 155(a)(2), 180(c), 17 C.F.R. §§ 201.155(a)(2), .180(c); *see, e.g.*, *Benham Halali*, Exchange Act Release No. 79722, 2017 WL 24498, at *3 n.12 (Jan. 3, 2017).

[10] *See, e.g.*, *McBarron Capital LLC*, Exchange Act Release No. 81789, 2017 WL 4350655, at *3-5 (Sep. 29, 2017); *Bennett Grp. Fin. Servs., LLC*, Exchange Act Release No. 80347, 2017 WL 1176053, at *2-3 (Mar. 30, 2017); *Apollo Publ'n Corp.*, Securities Act Release No. 8678, 2006 WL 985307, at *1 n.6 (Apr. 13, 2006).

6-13-19

Admin. Proc. File No. 3-18791

Please explain in writing what I am being accused of. Please be specific as of dates and actions.

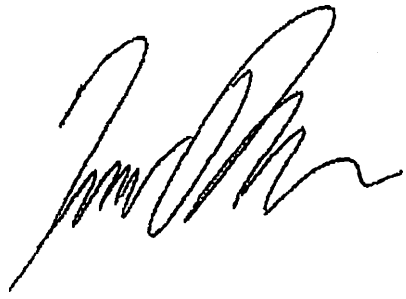


EXHIBIT 9

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-18791

In the Matter of **TRAVIS A. BRANCH,** **Respondent.**	**DIVISION OF ENFORCMENT'S REPLY TO RESPONDENT'S OPPOSITION TO ORDER TO SHOW CAUSE**

Pursuant to the Order to Show Cause, Securities and Exchange Act of 1934 ("Exchange Act") Rel. No. 85970 (May 30, 3019), the Division of Enforcement ("Division") hereby submits its reply to Travis A. Branch's ("Respondent's") opposition to the order to show cause.

I. INTRODUCTION

On September 19, 2018, the Securities and Exchange Commission issued an order instituting an administrative proceedings ("OIP") against Respondent pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Investment Advisers Act of 1940 ("Investment Adviser Act"). The OIP advised Respondent that on August 7, 2018, the U.S. District Court for the Southern District of Florida had entered an amended final judgment against him, permanently enjoining him from future violations, direct or indirect, of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in *Securities and Exchange Commission v. William Betta, Jr., et al.*, Civil Action Number 09-80803-CIV-MARRA (S.D. Fla.). The OIP summarized the allegations the Division made against Respondent in the complaint and, based on those allegations, advised Respondent that the OIP was initiated to determine: (1) whether the allegations are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; (2) what, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and (3) what, if any, remedial action

is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

On May 10, 2019, the Commission issued an order directing the Division to file a status report concerning service of the OIP on Respondent. On May 28, 2019, the Division filed a status report evidencing that service of the OIP was made on September 27, 2018, pursuant to Rule 141(a)(2)(i) of the Commission's Rules of Practice. This meant that Respondent's answer was required to be filed within 20 days of service of the OIP, yet no answer had been filed as of the Commission's May 10, 2019 order.

On May 30, 2019, the Commission issued a show cause order (the "OSC"). The Commission continued the prehearing conference indefinitely and ordered Respondent to show cause by June 13, 2019 "why he should not be deemed to be in default and why this proceeding should not be determined against him due to his failure to file an answer and to otherwise defend this proceeding." The Commission gave the Division 14 days from the date of service to file its reply to Respondent's opposition to the order to show cause. The Commission further ordered that if Branch failed to respond to the OSC, then the Division shall file its motion for default and other relief on or before July 11, 2019.

On June 13, 2019, Respondent faxed a handwritten, one line sentence attached to the last page of the Commission's May 30, 2019 OSC saying, "Please explain in writing what I am being accused of. Please be specific as of dates and actions."

II. ARGUMENT

A. Respondent Has Failed to Adequately Respond to the OIP and the OSC, Clearing the Way for the Division to File a Motion for Default and Sanctions on July 11, 2019

Respondent's one sentence response in no way "answers" the OIP and fails to explain why he did not file an answer sooner. Rule 220(c) of the Commission's Rules of Practice provides that an answer "shall specifically admit, deny or state that the party does not have, and is unable to obtain, sufficient information to admit or deny each allegation in the [OIP]." Respondent has done none of these things. Even if the Commission were to generously construe his one

sentence response as a motion for a more definite statement, Rule 220(d) states that such a motion "shall state the respects in which, and the reasons why, each such matter of fact or law should be required to be made more definite." It does not. Therefore, it is clear that the whole point of Respondent's one sentence response is to – without cause and for no good reason – further delay these proceedings and put off for as long as possible the sanction that he knows the Division will inevitably seek for his misconduct. The Commission should not allow Respondent to do this, or to flout the Rules of Practice in the process.

The Commission made it clear in its May 10, 2019 order that "[w]hen a party defaults, the allegations in the OIP will be deemed to be true and the Commission may determine the proceeding against that party upon consideration of the record without holding a public hearing." The OIP also informed Respondent that a failure to file an answer could result in his being deemed in default and the proceedings determined against him. Respondent chose not to heed any of these clear warnings.

III. CONCLUSION

For the foregoing reasons, the Division respectfully requests that Commission allow the Division to file a motion for default and other relief by July 11, 2019, or by such other date as the Commission deems appropriate.

June 25, 2019

Respectfully submitted,

/s/ Douglas Miller

Douglas M. Miller
Attorney for Division of Enforcement
Securities and Exchange Commission
444 S. Flower Street, Suite 900
Los Angeles, California 90071
Telephone: (323) 965-3998

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-18791

In the Matter of **TRAVIS A. BRANCH,** **Respondent.**	**CERTIFICATE OF SERVICE**

Douglas M. Miller, an attorney, hereby certifies that on June 25, 2019, he caused true and correct copies of the **DIVISION OF ENFORCMENT'S REPLY TO RESPONDENT'S OPPOSITION TO ORDER TO SHOW CAUSE** to be served on the following via UPS Next Day Air:

Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-2557

Respondent Travis A. Branch
[redacted]
Kanehoe, HI [redacted]

Dated: June 25, 2019

/s/ Douglas Miller
Douglas M. Miller
Division of Enforcement

EXHIBIT 10

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 86285 / July 2, 2019

Admin. Proc. File No. 3-18791

In the Matter of

TRAVIS A. BRANCH

ORDER REQUESTING ADDITIONAL WRITTEN SUBMISSIONS

On September 19, 2018, the Securities and Exchange Commission issued an order instituting administrative proceedings ("OIP") against Travis A. Branch pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940.[1] On May 10, 2019, we issued an order directing the Division to file a status reporte concerning service of the OIP.[2] On May 28, 2019, the Division filed a status report evidencinge that service of the OIP was made on Branch on September 27, 2018, pursuant to Rule 141(a)(2)(i) of the Commission's Rules of Practice.[3] As stated in the OIP, Branch's answer was required to be filed within 20 days of service of the OIP.[4]

On May 30, 2019, we issued an order to show cause why Branch should not be deemed to be in default because Branch had not filed an answer. The order directed Branch to submit by June 13, 2019 a response explaining "why he should not be deemed to be in default and why this proceeding should not be determined against him due to his failure to file an answer and to otherwise defend this proceeding." The order reminded the parties "that an electronic courtesy copy of each filing should be emailed to APFilings@sec.gov in PDF text-searchable format."[5]

---

1 *Travis A. Branch*, Exchange Act Release No. 84199, 2018 WL 4488873 (Sept. 19, 2018), https://www.sec.gov/litigation/admin/2018/34-84199.pdf ("*Branch I*").

2 *Travis A. Branch*, Exchange Act Release No. 85833, 2019 WL 2071384 (May 10, 2019), https://www.sec.gov/litigation/opinions/2019/34-85833.pdf ("*Branch II*").

3 Rule of Practice 141(a)(2)(i), 17 C.F.R. § 201.141(a)(2)(i). In addition to the official version available at 17 C.F.R. § 201.100, et seq., the Commission's Rules of Practice are also available online at https://www.sec.gov/about/rulesofpractice.shtml.

4 *Branch I*, 2018 WL 4488873, at *2.

5 *Travis A. Branch*, Exchange Act Release No. 85970, 2019 WL 2297286 (May 30, 2019), https://www.sec.gov/litigation/opinions/2019/34-85970.pdf ("*Branch III*").

On June 13, 2019, Branch sent an email to the APFilings@sec.gov mailbox with the following text: "Please explain in writing what I am being accused of. Please be specific as of dates and actions." Although subsequent filings by the Division of Enforcement indicate that Branch served this communication on the Division, Branch did not include a certificate of service with his communication. We remind the parties that Rule 151(d) of the Commission's Rules of Practice require that a certificate of service be included with all filings.[6e]

On June 26, 2019, the Division filed a reply to Branch's email. The Division argued that Branch's response is an inadequate answer to the OIP, does not respond to the order to show cause, and is intended solely to "delay these proceedings." Accordingly, the Division asked for leave to file a motion for default and other relief.

We agree that Branch's email did not satisfy his obligation to respond to the order to show cause by June 13, 2019. Specifically, Branch's email did not address the two issues identified in the order to show cause: why he should not be deemed to be in default, and why this proceeding should not be determined against him due to his failure to file an answer and to otherwise defend this proceeding. Nonetheless, although the email was not an adequate response to the order to show cause, it suggests that Branch may wish to participate in this proceeding.

Under the circumstances, we believe it is premature to grant leave for the Division to file a motion for default and other relief.[7] The Rules of Practice authorize the Commission to deem ae party in default under certain circumstances, including failure to file an answer.[8] But the Rulese of Practice "do not compel entry of default"; rather, in light of the "serious" consequences of a default, it is "a prudent practice . . . [in] considering the issuance of a default order against a respondent to first order that respondent show cause why a default is not warranted."[9] In light of e

---

6 17 C.F.R. § 201.151(d). We direct the parties' attention to Rules of Practice 150 through 153, 17 C.F.R. § 201.150–.153, which explain the service and filing requirements in more detail. We also remind the parties that filings emailed to APFilings@sec.gov are courtesy copies and not substitutes for compliance with the Rules of Practice governing service and filing of papers.

7 *See, e.g., McBarron Capital LLC*, Exchange Act Release No. 80662, 2017 WL 1953455, at *2 (May 11, 2017) (exercising discretion to permit an applicant to show cause why the Commission should reopen a review proceeding that had been dismissed because on the same day as the dismissal was issued the applicant made a "filing suggest[ing] that it [still] wishes to pursue an appeal"); *cf., e.g., Bravado Intern. Group Merchandising Servs., Inc. v. Ninna, Inc.*, 655 F. Supp. 2d 177, 187-88 (E.D.N.Y. 2009) (denying request to enter default against *pro se* defendant who filed six-sentence document that "communicate[d] . . . intent to deny plaintiffs' claim" even though it "[did] not admit or deny every allegation" and thus did not comply with Federal Rule of Civil Procedure 8(b) governing answers to a complaint).

8 17 C.F.R. § 201.222(f).

9 *David Mura*, Exchange Act Release No. 72080, 2014 WL 1744129, at *3 (May 2, 2014) (order remanding case for further proceedings).

that "prudent practice," this order again directs Branch to explain why he should not be deemed to be in default and why this proceeding should not be determined against him. A failure to make a filing in response to this order may result in Branch being held in default. We direct Branch's attention to the order to show cause for information about the consequences of default.[10] We also direct Branch's attention to the OIP, which contains the allegations against him.[11] We further direct Branch's attention to Rule of Practice 220, which governs the standards for filing motions for a more definite statement in connection with answers to an OIP.[12]

We also reset the deadlines set forth in the order to show cause. Branch's response to this order must be filed and served consistent with the Commission's Rules of Practice no later than July 16, 2019. If Branch files a response to this order to show cause, the Division may file a reply within 14 days after its service. If Branch does not file a response, the Division shall file a motion for default and other relief by August 13, 2019, consistent with the directions set forth in the order to show cause about the content of such motion.

Upon review of the filings in response to this order, the Commission will either direct further proceedings by subsequent order or issue a final order resolving the matter.

For the Commission, by the Office of the General Counsel, pursuant to delegated authority.

Vanessa A. Countryman
Secretary

---

10 *See Branch III*, 2019 WL 2297286, at *1.

11 *Branch I*, available online at https://www.sec.gov/litigation/admin/2018/34-84199.pdf.

12 *See* Rule of Practice 220, 17 C.F.R. § 201.220 (rule governing filing of answers).

EXHIBIT 11

Miller, Douglas

From: Miller, Douglas
Sent: Wednesday, October 10, 2018 12:48 PM
To: [redacted]
Cc: [redacted]
Subject: Call from Corey Branch

I received a call today from Corey Branch ([redacted]-2670), who said he is Travis Branch's brother. He said that his TD Ameritrade account (#[redacted]) had been "blocked" and would not allow him to do a wire transfer or something last week. He does not speak very clearly at all, so it was hard to understand what led him to call me and how he got my number. He made it sound like he spoke with someone at TD Ameritrade and they gave him my number, but I don't know if he just made it seem that way and he actually got my number from Travis. It's also possible I just misunderstood what he was saying because of how hard it is to understand what he's saying. It wouldn't surprise me if he got my number from Travis because Travis called me a bunch of times in the last couple of weeks and would have my number handy. Corey said Travis handles some of his investments, which makes me wonder if Travis ripped him off and he's using us (me) as a cover story. [redacted] I plan to call him back this afternoon.

Douglas M. Miller
Senior Trial Attorney, Division of Enforcement
US Securities and Exchange Commission
444 South Flower Street, Suite 900
Los Angeles, CA 90071
Ph: [redacted]
Fax: 213.443.1905
[redacted]@sec.gov