

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C07010099
v.	:	
	:	Hearing Officer – AWH
THOMAS A. TIMBERLAKE	:	
(CRD #870022),	:	
	:	
Tampa, FL	:	Hearing Panel Decision
	:	
	:	
Respondent.	:	May 27, 2003

Formerly registered representative made material misrepresentations and omissions, in violation of NASD Conduct Rule 2110. Respondent fined \$25,000, suspended in all capacities for two years, ordered to make restitution and to offer rescission to customers, and assessed costs.

Appearances:

Gene E. Carasick, Esq., and Joel R. Beck, Esq., for the Department of Enforcement

Reginald R. Garcia, Esq., for Thomas A. Timberlake

DECISION

Introduction

On December 12, 2001, the Department of Enforcement (“Enforcement”) filed a five-cause Complaint in this matter against Thomas A. Timberlake (“Timberlake” or “Respondent”), alleging violations of NASD Conduct Rule 2110. The Complaint alleged that Timberlake made material misrepresentations and omissions in connection with the sale of long-term callable Certificates of Deposit (“CDs”) to five customers.

On January 29, 2002, Timberlake filed an Answer to the Complaint denying the alleged violations, and requested a hearing. A hearing was held in Tampa, Florida, on November 21 through 22, 2002, before a hearing panel composed of the Hearing Officer and two members of District Committee No. 7. Both parties filed Post-Hearing Briefs on January 30, 2003.

Findings of Fact¹

I. RESPONDENT'S BACKGROUND

Timberlake has been working in various capacities in the financial services, insurance, and securities industries for the last twenty-four years. Tr. 252-58. In 1989, Timberlake was registered through an NASD member firm when he established his own financial consulting practice, The Timberlake Financial Group ("TFG"). TFG is not an NASD member firm. Tr. 258. TFG primarily sells insurance products, but also provides other financial services such as retirement, tax, and estate planning. Tr. 253-54, 256. From August 1996 to December 1999, the time period pertinent to the Complaint, Timberlake was registered as a general securities principal, general securities representative, and registered options principal for Palm State Equities, Inc. ("Palm State"). Tr. 257; CX 1, at 5. He is not currently registered with NASD.

II. THE CALLABLE CDS

Each cause of the Complaint alleges that Timberlake made material misrepresentations or omissions in the sale of long-term callable CDs. Specifically, the Complaint alleges that Timberlake failed to disclose to customers (1) the long-term nature of the investment, and (2) the secondary market risk if the customer chose to liquidate the CD prior to maturity.

The customers who testified at the hearing understood, from their discussions with Timberlake, that a callable CD was one which the bank could call, or redeem, at any time after

¹ References to Enforcement's exhibits are designated as CX_; Respondent's exhibits as RX_; and the transcript of the hearing as Tr._.

the expiration of a certain non-callable period. Tr. 51-52, 140, 189, 215. If the bank did not call the CD, the customer would continue to hold the CD, earning interest at rates as high as 8%. Tr. 56-57, 140, 215. The CDs could vary in amount, could pay interest monthly or semi-annually, and could be issued by a variety of banks. Tr. 270.

All of the customers were looking for investments that would last no longer than one to two years. Tr. 51, 139-40, 189, 214-15; CX 5. They all believed that the callable CDs they purchased from Timberlake were short-term investments. However, all of the CDs they purchased had a maturity of twenty years. Tr. 59-60, 154-55, 195, 219-20.

Timberlake advertised the CDs and sent correspondence to customers on the letterhead of TFG. However, the account statements and confirmations sent to customers came from Palm State. *See, e.g.*, CX 2, at 2-3, CX 9, CX 12-14.

III. PURCHASES OF THE FIVE CUSTOMERS

A. CUSTOMER RL

RL was sixty-two years old when he bought callable CDs from Timberlake. Tr. 62. RL had retired in 1997 from his job in sales and marketing at a glass packaging company. Tr. 49. His only investment experience was with a managed corporate 401(k) account. Tr. 49. He never had purchased a CD prior to his dealing with Timberlake. Tr. 49-50. RL and his wife sold their house in October of 1998, and temporarily put the proceeds into a money market account earning interest of approximately two and one-half to three percent. Tr. 50. RL and his wife were deciding where they wanted to live permanently, whether they wanted to live on a large boat, live abroad, or remodel a rental home. Tr. 51. Consequently, RL told Timberlake that he did not want to tie up his money for more than eighteen months to two years. Tr. 51.

On November 9, 1998, RL and his wife purchased a \$20,000 callable CD issued by LaSalle National Bank. The CD had an initial interest rate of seven percent, and a reduced rate of six percent after one year. Tr. 54; CX 18 at 1. Pleased with the interest they received on the first CD, they purchased a second CD on July 23, 1999. Tr. 55-56; CX 18 at 2. The second CD, in the amount of \$22,000, was also from LaSalle National Bank, but had an initial interest rate of eight percent and a reduced rate of six and one-eighth percent after one year.² CX 18 at 2. RL's CDs had maturity dates of November 23, 2018, and February 26, 2019, respectively. CX 18 at 1-2.

B. CUSTOMER CM

Customer CM was seventy-one years old at the time of the hearing. He retired in 1990 after a career as a pharmaceutical representative. Tr. 137. CM had an IRA rollover that was invested in mutual funds, CDs, and cash reserves. Tr. 137-38. However, he never had invested in a CD with a maturity of longer than two years. Tr. 139. When he met with Timberlake, CM told him that he was looking to invest his money for only two years. Tr. 139-40.

Customer CM purchased a \$10,000 CD from LaSalle National Bank on March 26, 1997. Tr. 141; RX B6. After the bank called this CD, CM purchased a \$100,000 CD from LaSalle National Bank on November 9, 1998. That CD had an interest rate of seven percent that stepped down to six percent after one year. Tr. 144; RX B17. He purchased another callable CD on December 4, 1998, for \$100,000 from European American Bank. The CD had an interest rate of seven percent that stepped down to six percent after one year. Tr. 145; RX B17. On December 10, 1998, he purchased a callable CD for \$100,000 from Provident Bank, again with an interest rate of seven percent that stepped down to six percent after one year. Tr. 147; RX B17. On

² This second CD was actually purchased on the secondary market, but, as RL testified, he did not know that it was bought on the secondary market, nor did he know what a secondary market was. Tr. 57.

March 11, 1999, he purchased his fifth CD. When Timberlake asked him if he needed the income to live on, and he responded that he did not, Timberlake recommended that CM buy a zero coupon CD. Accordingly, CM bought a \$400,000 zero coupon CD, issued by LaSalle National Bank, for which he paid \$96,185. Tr. 149-50; RX B17. On April 28, 1999, CM purchased a \$100,000 CD, issued by Standard Federal Bank. Finally, CM bought his seventh CD from Timberlake, a \$46,000 zero coupon CD, issued by LaSalle National Bank. That CD was bought in the secondary market for \$13,994. Tr. 150-54; RX B17. The first CD had a 15-year maturity date; the other six had 20-year maturity dates. RX B17.

C. Customer LW

Customer LW was sixty-nine years old at the time of the hearing. Tr. 186. LW worked on his parent's farm until, at the age of seventeen, he joined the United States Air Force. He retired from the Air Force 1973. Tr. 186. LW's only investments had been in local bank CD's that had maturities ranging from six months to five years. Tr. 187. Timberlake told LW that the only difference between a regular CD and a callable CD was that the bank could redeem the callable CD at any time. LW and his wife discussed the investment and told Timberlake that they wanted to invest in a one-year callable CD. Tr. 190-91.

On February 18, 1999, LW and his wife purchased a \$20,000 CD from LaSalle National Bank, with an initial interest rate of seven and one-half percent that stepped down to six percent after one year. Tr. 192; RX E10. The CD had a maturity date of February 19, 2019. RX E10.

D. Customer DP

Customer DP was a fire-chief until he retired, and currently works part-time as a bus driver. Tr. 213. At the time of hearing, DP was fifty-six years old and married. Tr. 213. He had retirement accounts that were invested in a few stocks, including dividend reinvestment

programs and mutual funds. Tr. 213. He had purchased CDs from banks, but only CDs with maturities of less than one year. Tr. 213-14. DP wanted to invest in “something safe that would give [him] some income for a short period of time. [He] just wanted to park some money and get a better interest rate than what the banks were paying.” Tr. 214.

DP and his wife purchased from Timberlake an \$11,000 callable CD issued by the Bank of Hapolim with an interest rate of eight and one-quarter percent that stepped down to six and one-quarter percent after one year. Tr. 217; CX 30; RX F8. The CD had a maturity date of March 26, 2019. CX 30; RX F8.

E. CUSTOMER AD

Customer AD was in his seventies at the time he first spoke to Timberlake. CX 5. AD did not attend the hearing, but he executed a Declaration, introduced by Enforcement as CX 5. In that Declaration, AD stated that because of his age, “I told Timberlake . . . I did not want my investments to be tied up for long period of time. I asked him if I purchased this callable c.d. would my money be tied up for 5 to 10 years and Timberlake said no.” CX 5.

Based on Timberlake’s recommendation and representations, AD purchased a \$30,000 callable CD issued by LaSalle Bank on December 3, 1997. CX 5. On December 3, 1998, the bank called this CD. CX 5. At Timberlake’s suggestion, on December 4, 1998, AD reinvested his principal and interest in another callable CD from LaSalle National Bank in the amount of \$35,000 with an initial interest rate of seven percent stepped down to six percent after one year. CX 5; RX C12. AD also purchased: a \$10,000 callable CD from LaSalle National Bank, with an interest rate of seven percent, on May 8, 1998; a \$100,000 callable CD from European American Bank, with an interest rate of six and seven tenths percent on May 8, 1998; and a \$15,000 callable CD from LaSalle National Bank, with an initial interest rate of seven and one-half

percent stepped down to six percent after one year, on July 26, 1999. CX 5; RX C12. The CDs had maturity dates of December 21, 2018; May 8, 2018; May 8, 2018; and January 27, 2019, respectively. RX C12.

III. TIMBERLAKE'S SALES PRACTICE AND PRESENTATION

A. NEWSPAPER ADVERTISING

Timberlake attracted customers to his firm, TFG, by advertising the callable CDs in local newspapers. RX B1, RX C1, RX D1, RX E1, RX F1. Several customers were attracted by the offer of FDIC-insured CDs with rates that were higher than they were otherwise earning. Tr. 50, 74, 139. The ads included the language, "some restrictions apply" and "subject to availability." Tr. 78, 166-67, 224; RX B1. No customer purchased a callable CD simply based on the information in the newspaper advertisement. Tr. 268-69. Each customer had either an in-person or telephone meeting with Timberlake during which more information was discussed.

B. PHONE CALL INITIATION AND SALES PACKET

When customers made their initial phone call to Timberlake, he asked for their addresses to send out a sales packet, and he provided them with additional information about the callable CDs, using a set format that he referred to as the "Callable CD Phone Intake." Tr. 271; CX 3. In this initial phone call, Timberlake explained that interest could be paid monthly or semi-annually, that there was a \$10,000 minimum investment, and that the CDs were FDIC insured. He defined the term "callable" by stating that the bank could not redeem the CD during the first year, but thereafter, "if the bank doesn't want to rent your money at 7.00%, they can give you 2 weeks notice and can call-it-in or redeem it, even if you might not really want to give it up. And that's how the Callable CDs work." CX 3. Nowhere in the "Callable CD Phone Intake" format are maturity dates or secondary market risk mentioned.

The sales packet described the callable CDs, various interest rates, and general information about other financial services Timberlake's firm provided, as well as what times customers could come in for appointments. Tr. 271-72, 283-84. The customers also received a "thank you for your interest" letter, which further explained the callable CDs. CX 4, CX 9, CX 15, CX 20, CX 27. However, these materials did not mention maturity dates or secondary market risk.

C. MEETING

The evidence of what took place at the sales meeting with Timberlake in his office is conflicting. Timberlake testified that he would seat the customers around a table in his office. Tr. 285. If there were two people, he would sit in the middle so that each customer could see anything he might hold up or write on a piece of paper. Tr. 285-86. He used a "Callable check list" system to facilitate this meeting. Tr. 301; RX B4, RX C4, RX D4, RX E4, RX F4. These meetings lasted from one hour and fifteen minutes to two hours each. Tr. 284.

He testified that, as he covered a topic on his check list, he physically checked off the topic on the check list. Tr. 297. He also testified that he used the check list, as well as a "CD Features Worksheet," to make calculations and take notes to show the customers how the callable CDs would work uniquely for them. Tr. 301, 303; RX B9, RX C13. Maturity dates and secondary market risk were noted on the check list and the CD Features Worksheet. Tr. 304, 309, 313, 316-17, 319-20, 323, 331, 334-35. He testified that, unless a customer asked a question, he would just keep moving along in his presentation and assume that the customer understood everything that he was saying. Tr. 300.

Timberlake testified that not only did he disclose the maturity dates of the CDs during his sales presentation, but he placed the order for the CD by telephone within earshot of the

customers, and they were in a position to hear him state the maturity date to the trader on the other end of the phone line. Tr. 305.

Timberlake also testified that he explained the concept of secondary market risk to the customers through the use of his “see saw” analogy: “If interest rates are about the same, bond prices is (sic) one kid – two kids on a see-saw – rates are the other kid. If interest rates are high, bond prices, CD prices can be low, temporarily, until that changes. Interest rates are low, bonds prices are going to be high.” Tr. 298.

As Timberlake testified, however, this meeting was really a means to another end. He stated that the callable CDs were of no real importance to him. His commissions and income were driven largely by his sale of retirement and insurance investments, and he hoped that by offering these callable CDs, he would be able to draw the customers’ attention to other investments and financial services that his firm provided. Tr. 257, 262-63, 270-71. He estimated that, over a three year period, he opened approximately one hundred accounts for customers who purchased approximately two hundred callable CDs for approximately seven or eight million dollars. Tr. 266-67. His objective was to retain his customers “not for a couple of years, but for ten or fifteen.” Tr. 290-91.

The customers’ testimony about the meetings was quite different. All but one testified that Timberlake did not discuss the maturity of the CDs. Tr. 52, 140, 192-93. They were aware of a non-callable period of one or two years, but they were not told of any time period as great as fifteen to twenty years. One customer thought he could keep the CD as long as he chose. Tr. 57. The one customer who came away from the meeting with an understanding of the maturity date thought it was the two-year non-callable period. Tr. 215-16.

The customers believed that they could liquidate their CDs at any point, simply by giving Timberlake about a week's notice to process the transaction through Palm State. Tr. 52, 57. He assured them that there was no risk to principal, and that, at most, they might lose some interest upon liquidation. Tr. 52, 57, 193. They testified that Timberlake did not disclose any risk of loss in the secondary market. Tr. 52, 190, 216-17. Customer CM testified that each time he purchased a CD from Timberlake, he asked the same question: "If it cannot be called the first year, can I cash it in, can I be liquid on par value after one year?" Tr. 141-42. Each time he asked the question, he got the same answer "yes" from Timberlake. Tr. 142. Customer LW testified that he asked Timberlake about withdrawing funds after one year, and that Timberlake explained that he could withdraw the funds with no penalty. Tr. 193. DP testified that "[s]afety and FDIC insured, that was stressed, but never risk." Tr. 217. All the customers testified that, had they been aware of the long maturity dates and the risk of loss in the secondary market, they would not have purchased the callable CDs. Tr. 62, 161-62, 201, 223-24.

D. MONTHLY STATEMENTS

All customers received confirmations of their purchases and monthly account statements from Palm State. The maturity dates for the callable CDs were listed on the account statements. CX 8, CX 13, CX 19, CX 25, CX 31, RX B12-13, 17, RX C11-12, RX D10-11, RX E10-11, RX F8-9. However, the customers either did not notice the maturity date on the confirmations and account statements or didn't find that information significant. Customer CM saw a maturity date listed, but stated that the date was of no concern to him because Timberlake reassured him that, after one to two years, he could cash-in the CD for par value. Tr. 143. LW never noticed the date in the corner because he knew he had purchased one year callable CDs. Tr. 194.

IV. CUSTOMER LOSSES

After Palm State notified the customers that it was going out of business and that the customers would need to find new firms to manage their CDs, the customers discovered that they actually owned long-term investments that could not easily be liquidated. RL transferred his CDs to Southtrust Securities in January of 2000. Tr. 60. One of them was called by the bank, but he still owns the others and is receiving payments at six percent. Tr. 135. CM sold his CDs on the secondary market. He sold a \$100,000 CD for \$97,000. He paid \$96,000 for a \$400,000 zero-coupon CD, and received \$112,000 for that CD when he sold it. However, he never received any of the interest, which was to be compounded, on that CD. Tr. 157, 159-60. LW transferred his CD to Charles Schwab, and then sold it, losing approximately \$400. Tr. 198. DP has attempted to sell his \$11,000 CD, but has not been willing to sell it at the highest bid of \$9,600. He still receives his interest payments on the CD. Tr. 222. AD still owns the four CDs. CX 5.

Discussion

NASD Conduct Rule 2110 requires registered representatives to observe “high standards of commercial honor” and “just and equitable principles of trade.” Misrepresentations and omissions that mislead customers violate Conduct Rule 2110. *See, In re Ramiro Jose Sugranes*, Exchange Act Rel. No. 35311, 1995 SEC LEXIS 234 (Feb. 1, 1995) (misrepresentations in connection with sale of certificates of deposit to make the investments more attractive to customers).³ Proof of scienter is not required to prove a misrepresentation violation under Conduct Rule 2110. *DBCC v. Euripides*, No. C9B950014, 1997 NASD Discip. LEXIS 45, at *18 (NBCC July 28, 1997).

³ Rule 2110 applies to all business related misconduct, regardless of whether the misconduct involved securities. *See Dept. of Enforcement v. James S. Davenport*, No. C05010017, (NAC May 6, 2003).

The Hearing Panel finds that the customers consistently and credibly testified that they were interested only in short-term investments of from one to two years. All were retired and, with the exception of DP, were in their sixties or seventies when they purchased the callable CDs.⁴ Although CM told Timberlake that he did not need the income from the callable CDs to live on, he told Timberlake that he wanted to invest his money only for a period of two years. He had no reason to postpone longer than two years the income from zero coupon CDs that matured when he reached the age of eighty-eight.

Timberlake insisted that he disclosed the maturity date to the customers during their long hour and fifteen minute to two hour meetings at his office. However, he admitted that he has been accused of giving a “seminar” during these meetings, and he “probably got more on these people than in these people.” Tr. 293. Having observed his demeanor while testifying in extended monologue fashion, the Hearing Panel agrees with that assessment. Timberlake gave long lectures to his customers, but failed to listen to his customers’ articulated needs and interests. In the face of the customers’ desire for one to two year investments, and Timberlake’s repeated emphasis that “the chances of this thing [the CD] getting to final maturity are a lot slimmer than winning the lottery two weeks in a row,” it is evident to the Hearing Panel that the customers only absorbed and understood his emphasis on the expected short nature of their investments. Tr. 300, 345.

When asked whether he told customer AD that his money would not be tied up for as long as five or ten years, Timberlake testified that “I have never given anybody a specific bullet type when something is going to mature because I can’t do it.” Tr. 320. It is clear to the Hearing Panel that, whatever he actually said to these customers, they clearly understood that they were not making long-term investments, nor had they any interest in doing so. Consistent with that

⁴ At the time of the hearing, DP was fifty-six, had retired as a fire chief, but was working part-time.

understanding, none of them paid any attention to the maturity date that was noted along with the other information on their confirmation and monthly statements.

It is equally clear to the Hearing Panel that the customers were not meaningfully informed of the risks involved in the secondary market should they choose to liquidate their CDs prior to maturity. Timberlake repeatedly referred to his “teeter-totter” or “see-saw” analogy to describe the relationship between interest rates and bond prices. However, nowhere in his presentation to customers, nor in his hearing testimony, did he refer to the risk inherent in owning CDs that were thinly traded or issued by less than top-rated, well known financial institutions. There is no evidence that Timberlake knew the trading volume in the secondary market for the callable CDs he was selling, nor that he performed due diligence to ascertain the credit quality of the issuing institutions. For example, Timberlake was unable to secure a seven percent callable CD for customer DP, but, a week later, he found another one. Timberlake testified, “It was a new name, a name that was new to us, and it had a pretty good yield to get people interested in the name.” Tr. 316. The callable CD paid eight and one-quarter percent for two years, and then stepped down to six and one-quarter percent. Even though interest rates have gone down significantly since DP bought the \$11,000 CD, the highest bid he has gotten for it is \$9,600.

That information on maturity dates and secondary market risk was material to those customers. RL testified that if he had known that the CDs had twenty-year maturity dates, he never would have purchased them because he was sixty-two years old at the time and he was considering the purchase of a permanent residence after selling his house. Tr. 62. CM would not have bought a single CD if he knew about the long maturity dates, and the risks he would face if he attempted to liquidate the CD before it was called. Tr. 161-62. LW stated that he “wouldn’t

touch” one of the CDs if he had been aware of the long maturity date and the secondary market risk. Tr. 201.

The customers were not experienced, sophisticated investors who Timberlake could reasonably expect would comprehend and evaluate the risks of buying financial instruments with long-term maturities and thin secondary markets, based on a lengthy, technical, yet superficial lecture delivered during a sales pitch emphasizing high returns and the safety of federal insurance. To fulfill his fiduciary obligations under Rule 2110, Timberlake was required to provide a clear and meaningful disclosure, so that these customers could understand and fairly evaluate the risks of investing in the callable CDs. Instead, he utilized a uniform presentation of information that overwhelmed his customers - information that they were unable to grasp or in which they were not interested. He, on the other hand, failed to acknowledge or address their articulated interest only in relatively short-term investments. As he stated, if the customers failed to ask a question, he “just kept moving along,” and assumed that the customers understood everything he said. That is not sufficient. His failure affirmatively to address their interests was an intentional course of conduct that falls short of his fiduciary obligations. The Hearing Panel therefore finds that Timberlake violated Conduct Rule 2110 by failing adequately to disclose material facts concerning the sale of callable CDs to customers RL, CM, LW, DP, and AD.

Sanctions

The NASD Sanction Guidelines for misrepresentations or material omissions of fact call for a fine of \$10,000 to \$100,000, and, where the misconduct is intentional, a suspension for a period of ten business days to two years. In egregious cases, the Sanction Guidelines call for a bar. NASD SANCTION GUIDELINES, at 96.

Timberlake's conduct was a very serious breach of his fiduciary responsibilities because he took advantage of naïve, trusting customers who would not have purchased the CDs had they known about the true maturity dates and risks of selling them on the secondary market. His conduct was not an isolated incident. Five customers were involved, and their testimony, which was consistent and credible, demonstrates a pattern of conduct. The absence of complaints from other customers is not mitigating, as Timberlake would have it. Enforcement seeks a \$25,000 fine and a suspension for eighteen months. The Hearing Panel will fine Timberlake \$25,000, as requested by Enforcement. However, in view of the seriousness of the violation, the Hearing Panel believes that to remediate the misconduct and to protect the investing public, Timberlake should be suspended in all capacities for a period of two years.

The Sanction Guidelines also provide that, where appropriate to remediate misconduct, adjudicators should order restitution and/or rescission. NASD SANCTION GUIDELINES, at 6. Here, restitution is appropriate for those customers who have suffered a quantifiable loss as a result of Timberlake's misconduct. For those customers who have not sold their CDs, the Hearing Panel will order Timberlake to offer them rescission, that is, to offer to repurchase their CDs at the original purchase price. Finally, Timberlake will be assessed costs of \$2,776.45, consisting of a \$750 administrative fee and a \$2026.45 transcript fee.

Conclusion

For making material misrepresentations and omissions to customers, in violation of NASD Conduct Rule 2110, Thomas A. Timberlake is (1) fined \$25,000; (2) suspended in all capacities for a period of two years; (3) ordered to offer rescission by purchasing, at the original purchase price, the CDs he sold to, and which are still held by, customers RL, CM, DP, and AD;

(4) ordered to pay restitution in the amount of \$400 to customer LW, and \$3,000 to customer CM; and (5) assessed costs in the amount of \$2,776.45.

The sanctions shall become effective on a date determined by NASD, but not sooner than 30 days from the date this Decision becomes the final disciplinary action of NASD, except that, if this Decision becomes the final disciplinary action of NASD, the suspension shall become effective with the opening of business on Monday, July 21, 2003 and end at the close of business on Wednesday, July 20, 2005, and the fine shall become due and payable upon his reentry into the securities business.

SO ORDERED.

Alan W. Heifetz
Hearing Officer
For the Hearing Panel

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