

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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In the Matter of :  
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ZPR INVESTMENT MANAGEMENT, INC., and : INITIAL DECISION  
MAX E. ZAVANELLI : May 27, 2014  
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APPEARANCES: Amie Riggle Berlin and Robert K. Levenson representing the Division of Enforcement, Securities and Exchange Commission

Philip J. Snyderburn and K. Michael Swann representing Respondents ZPR Investment Management, Inc., and Max E. Zavanelli

BEFORE: Cameron Elliot, Administrative Law Judge

**SUMMARY**

This Initial Decision (ID) finds that Respondent ZPR Investment Management, Inc. (ZPRIM) violated Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 (Advisers Act) by misrepresenting compliance with Global Investment Performance Standards (GIPS) in magazine advertisements and investment report newsletters, and violated Advisers Act Sections 206(2) and 206(4) and Advisers Act Rule 206(4)-(a)(5) by making misrepresentations to Morningstar, Inc. (Morningstar), resulting in two false Morningstar reports on ZPRIM, and that Respondent Max E. Zavanelli (Max Zavanelli) aided and abetted ZPRIM's violations of Sections 206(1), 206(2), and 206(4) regarding the magazine advertisements and investment report newsletters. The ID orders, as to ZPRIM, censure, a cease-and-desist order, and civil penalties of \$250,000, and as to Max Zavanelli, a permanent bar from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization, a cease-and-desist order, and civil penalties of \$660,000.

## I. INTRODUCTION

### A. Procedural Background

The Securities and Exchange Commission (Commission) issued its Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on April 4, 2013, pursuant to Sections 203(e), 203(f), and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). ZPRIM and Max Zavanelli (collectively, Respondents) filed a joint Answer on April 29, 2013.

A hearing was held on September 30, 2013, and October 1, 15-17, and 24-25, 2013, at the Commission's headquarters in Washington, D.C. The admitted exhibits are listed in the Record Index issued by the Secretary of the Commission on May 5, 2014. The Division of Enforcement (Division) and Respondents thereafter filed post-hearing briefs and post-hearing reply briefs by December 19, 2013.<sup>1</sup>

On September 23, 2013—the day on which the hearing was originally scheduled to commence—the parties asked for a one-day continuance so that the Division and Respondents could explore production of an internal electronic portal (ZPR Portal) used by Respondents that the Division alleged ZPRIM withheld from production during the Commission's investigation. Tr. 6-8. The Division represented that it learned about the ZPR Portal on September 22, 2013, during preparation of a witness, and that the parties would need more time to determine what information should be produced and whether the data was available. Tr. 6-8. I adjourned the hearing until the next day. Tr. 12. On September 24, 2013, the parties requested a multi-week continuance to work on outstanding issues surrounding the ZPR Portal. Tr. 17-39. I denied the request, but granted the parties a one-week continuance, to September 30, 2013, to regroup and recall witnesses. Tr. 34-35. On October 1, 2013, the Division requested that I issue a subpoena to ZPRIM to produce documents from the ZPR Portal and communications from ZPRIM's email system, which I issued (Trial Subpoena). Tr. 315, 323. ZPRIM produced approximately 860,000 documents from the portal and ZPRIM email system to the Division by October 11, 2013. Respondents' Initial Notice of Partial Compliance With Trial Subpoena (filed Oct. 8, 2013); Respondents' Second Notice of Partial Compliance With Trial Subpoena (filed Oct. 11, 2013); see Tr. 571-72. On October 11, 2013, counsel for ZPRIM filed a request for temporary relief from further production in order to focus efforts on representing the Respondents at the hearing. Respondents' Motion for Temporary Relief From Compliance With Trial Subpoena (filed Oct. 11, 2013). I granted a stay of the Trial Subpoena on October 11, 2013, and I subsequently deemed production under the Trial Subpoena complete. Tr. 1341-42.

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<sup>1</sup> Citations to the transcript of the hearing are noted as "Tr. \_\_\_\_." Citations to exhibits offered by the Division and Respondents are noted as "Div. Ex. \_\_\_\_" and "Resp. Ex. \_\_\_\_", respectively. The Division's and Respondents' post-hearing briefs are noted as "Div. Br. \_\_\_\_." and "Resp. Br. \_\_\_\_", respectively. The Division's and Respondents' post-hearing reply briefs are noted as "Div. Reply \_\_\_\_" and "Resp. Reply \_\_\_\_," respectively.

## **B. Summary of Allegations**

The instant proceeding concerns allegedly misleading performance return advertisements by Respondents, arising from Respondents' failure to comply with GIPS. GIPS is a standardized set of voluntary, ethical principles for investment advisers; it is published by the CFA Institute, is based on ideals of full disclosure and fair representation, and includes guidance on how to calculate and to report investment performance results to prospective clients. OIP at 3. GIPS includes specific guidelines required for performance advertisements, when those advertisements claim GIPS compliance. Id. The OIP alleges that ZPRIM, through Max Zavanelli, made false claims that its performance result presentations complied with GIPS in six magazine advertisements in October, November, and December 2008, and in February and May 2011. Id. at 2-5. The OIP alleges that by omitting GIPS-required information in the October, November, and December 2008 advertisements, ZPRIM concealed the fact that it was underperforming one of its benchmarks rather than outperforming it. Id. at 1-2. The OIP further alleges that: ZPRIM, through Max Zavanelli, distributed monthly investment report newsletters that advertised performance returns while falsely claiming GIPS compliance in April and December 2009; ZPRIM, through Max Zavanelli, advertised performance returns in reports published by Morningstar, for the periods ending September 30, 2010, and March 31, 2011, during the Commission's investigation of ZPRIM, falsely claiming in both that there was no pending investigation by the Commission; ZPRIM, through Max Zavanelli, falsely claimed in the September 30, 2010, Morningstar report that performance returns of ZPRIM's Fundamental Small Cap Value Composite (SCV Composite) had been "audited" by Ashland Partners & Company, LLP (Ashland), instead of correctly reporting that Ashland had "verified" the results' compliance with GIPS; and the September 30, 2010, Morningstar report falsely claimed that Ashland had audited ZPRIM's SCV Composite performance returns for the period "December 31, 2000 to the present," when Ashland had resigned as ZPRIM's GIPS verifier in July 2010, and Ashland's last attestation report for ZPRIM concerned results for the period ended December 31, 2009. Id. at 5-6.

The OIP alleges that ZPRIM willfully violated Sections 206(1) and 206(2) of the Advisers Act; that Max Zavanelli violated or, in the alternative, aided and abetted and caused ZPRIM's violations of Sections 206(1) and 206(2) of the Advisers Act; and that ZPRIM willfully violated, and Max Zavanelli aided and abetted and caused ZPRIM's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by advertising untrue statements of material fact. Id.

Respondents admit in their Answer that the six magazine advertisements from October, November, and December 2008, and February and May 2011, standing alone, fail to comply with GIPS advertising guidelines, but deny that the advertisements constitute materially misleading claims of performance returns. Answer at 3-6. Respondents deny that the April and December 2009 investment report newsletters failed to comply with GIPS or were misleading. Id. at 6. Respondents admit that the September 30, 2010, Morningstar report incorrectly stated that Ashland "audited" its performance results and had not attested to performance results past December 31, 2009, but aver that these were typographical errors and were not materially misleading. Id. at 6-7. Respondents deny that ZPRIM falsely indicated in the September 30, 2010, and March 31, 2011, Morningstar reports that there was no pending Commission

investigation. Id. at 7. Respondents deny violating the Advisers Act and the rules thereunder. Id. at 7-9.

## II. FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments, proposed findings, and conclusions that are inconsistent with this ID.

### A. Background

#### 1. Max Zavanelli

Max Zavanelli was sixty-seven years old at the time of the hearing. Tr. 1350. He earned a bachelor's degree in business administration from Baruch College and attended four years of a Ph.D. program in finance at Columbia University's business school, but left before graduating. Tr. 1357-58. After working for a couple of years at Mellon Bank in Pittsburgh as a senior financial analyst and at American National Bank of Chicago as a stock market theoretician and investment strategies analyst, he created Zavanelli Portfolio Research in 1979, through which he sold financial research to institutions and money managers. Tr. 739, 1358-61. In 1982, prompted by research subscribers, he registered Zavanelli Portfolio Research as an investment adviser. Tr. 1361.

In 1987, the Commission made findings, pursuant to an offer of settlement from Max Zavanelli and Max Zavanelli d/b/a Zavanelli Portfolio Research, that he, without admitting or denying any allegations, violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) for performance return claims in a 1986 Form ADV and for claims regarding his educational background in a 1982 Form ADV. Tr. 1362-67; Div. Ex. 12; Resp. Ex. 33. Max Zavanelli and Zavanelli Portfolio Research were censured and prohibited from soliciting or accepting new clients for 180 days. Div. Ex. 12 at 3. Zavanelli has had no disciplinary issues with the Commission since the 1987 order. Tr. 742, 752, 1367-68.

In 1991, Max Zavanelli moved from Chicago, Illinois, to teach and manage a student investment fund at Stetson University in Deland, Florida, and he moved his research and money management business with him. Tr. 1368-70. In 1994, he split Zavanelli Portfolio Research into three separate companies: ZPRIM, ZPR International, and ZPR Investment Research. Tr. 741-42, 1371. ZPR Investment Research is no longer active. Tr. 329. In 1998, ZPR International was re-headquartered in Lithuania and continues to provide money management services outside of the United States; ZPR International operates independently from ZPRIM and has separate personnel. Tr. 175, 327, 1376. ZPR International's offices in Lithuania house ZPR Service Co., a research company that provides research to ZPRIM. Tr. 328. Max Zavanelli is currently a forty-nine percent owner of ZPR International. Tr. 1375.

Max Zavanelli spends only about a quarter of his time in the United States. Tr. 786. Ted Bauchle (Bauchle), a former ZPRIM employee, testified that Max Zavanelli still made all day-to-

day decisions for ZPRIM until his son, Mark Zavanelli, took over as president and chief compliance officer, despite Max Zavanelli spending little time in the United States. Tr. 145-46, 753. Max Zavanelli was responsible for, and had final authority over, the creation, distribution, and publication of all marketing and advertising materials for ZPRIM, prior to the time Mark Zavanelli became president and chief compliance officer. Tr. 1483-84, 1695-96; Div. Ex. 89 at 29. Max Zavanelli admitted that he was responsible for ensuring that ZPRIM's marketing materials were GIPS compliant and for making all claims of GIPS compliance on ZPRIM's behalf. Tr. 1557; Div. Ex. 89 at 46. According to Bauchle, Max Zavanelli was the "boss man," and he made all decisions. Tr. 429.

Max Zavanelli believes he is "possibly the best money manager," because of his "spectacular" numbers. Tr. 1715. He testified that a twenty-year study of ZPRIM's returns showed his performance second among money managers. Tr. 1715. Only Peter Lynch of Fidelity had better performance, "but he didn't have as long a track record." Tr. 1715.

Max Zavanelli was the president of ZPRIM from its inception, and chief compliance officer from 2009 to 2011; in 2011, he turned both roles over to Mark Zavanelli. Tr. 753, 1482, 1599. Until December 2011, Max Zavanelli "made all final decisions on behalf of" ZPRIM. Tr. 1833. He remains heavily involved in ZPRIM business, and continues to serve as ZPRIM's director and treasurer. Tr. 757-58, 1228-29, 1480, 1612-13, 1615; Div. Ex. 98. He regularly consults with Mark Zavanelli, and they discuss and make many decisions together about ZPRIM. Tr. 1599-1600, 1612-13. But, according to Max Zavanelli, Mark Zavanelli now makes all final, non-investment decisions. Tr. 1600, 1608. Max Zavanelli continues to make investment decisions for ZPRIM and receives daily reports from ZPRIM on performance and valuation. Tr. 1608.

## 2. ZPRIM

ZPRIM is a registered investment adviser located in Orange City, Florida. Tr. 1361, 1370; ZPRIM Form ADV filed December 12, 2013 (2013 Form ADV).<sup>2</sup> As of its last Form ADV, filed December 12, 2013, ZPRIM had approximately 105 clients and approximately \$164 million in assets under management. 2013 Form ADV. ZPRIM began with four employees when it opened in 1994, has fluctuated in size to as many as sixteen employees, and currently has five employees. Tr. 1371, 1850. ZPRIM maintains several composites, including the SCV Composite, the Global Equity Composite, the Earnings Quality and True Profitability (EQTP) Composite, and the All Asian Composite. Tr. 216, 418, 553; Div. Ex. 21; Resp. Ex. 16.

Until October 2011, Max Zavanelli owned one hundred percent of ZPRIM and was ZPRIM's president and chief compliance officer. Tr. 761-62, 1744. That month, Max Zavanelli transferred twenty-five percent of the company's shares to his son, Mark Zavanelli, in addition to making him president and chief compliance officer of ZPRIM. Tr. 761-62, 1744. Mark Zavanelli testified that he maintains final authority on all non-investment decisions, but that he

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<sup>2</sup> ZPRIM's most recent Form ADV was not introduced as an exhibit in the proceeding, but I take official notice of it as a document in the public official records of the Commission, pursuant to Rule 323 of the Commission's Rules of Practice. 17 C.F.R. § 201.323.

frequently consults and makes decisions with his father. Tr. 1762, 1785-86. On September 30, 2013, during the pendency of the hearing, Max Zavanelli transferred the remaining seventy-five percent stake in ZPRIM to Mark Zavanelli, making Mark Zavanelli the one-hundred percent owner of ZPRIM. Tr. 761, 1615. Max Zavanelli testified that the arrangement for Mark Zavanelli to join ZPRIM always included a transfer of one-hundred percent ownership, but that the formal change in control took nearly two years due to legal and regulatory hurdles. Tr. 761, 1616-17.

A composite is an aggregation of individual investment portfolios representing a similar investment objective or strategy. See Div. Ex. 25 at App. E. ZPRIM's composites have had good years and some bad years, and performance in parts of 2008 and 2009 was particularly poor. The April 30, 2009, board minutes reported that ZPRIM realized income of less than \$7,000 in 2008. Tr. 1216-17; Div. Ex. 79. Max Zavanelli loaned ZPRIM money at least twice in 2009, in the amounts of \$60,000 and \$75,000. Tr. 1218-19, 1426-27; Div. Exs. 80, 82, 83. In March 2008, ZPRIM's SCV Composite recorded its worst, or close to its worst, month ever as compared to its Russell 2000 Index benchmark. Tr. 1497; Div. Ex. 18. The SCV Composite continued to underperform its benchmark intermittently through early 2009, though it outperformed another benchmark, the S&P 500 Index, in some of those same months. Tr. 1681-83; Div. Ex. 18.

Other than the 1987 settlement with the Commission, involving its predecessor, Zavanelli Portfolio Research, ZPRIM has not had any regulatory issues. Tr. 742.

### 3. Significant ZPRIM Employees and Related Parties

Ruth Ann Fay (Fay), Max Zavanelli's ex-wife, has worked for ZPRIM since 1994. Tr. 1227. Fay graduated with a bachelor's degree from Grinnell College and has a law degree from the John Marshall Law School. Tr. 1227. Fay was previously a licensed attorney in Illinois, but has not been licensed to practice law anywhere since sometime prior to 1993. Tr. 1228. Between 2006 and April 2009, Fay was ZPRIM's chief compliance officer.<sup>3</sup> Tr. 1229. Fay stepped down as chief compliance officer following concerns from Commission staff that Fay was not particularly capable, which they discovered during an examination of ZPRIM in February 2009. Tr. 1282-83. After Max Zavanelli took over as chief compliance officer, Fay remained at ZPRIM as a director and corporate secretary, reporting to Max Zavanelli, and after 2011, to Mark Zavanelli. Tr. 1228-29.

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<sup>3</sup> Fay testified that she became chief compliance officer in 2006, and that prior to 2006, when ZPRIM registered as an investment adviser after a gap in registration, the position of chief compliance officer did not exist. Tr. 1229, 1289. Max Zavanelli referred to her as the firm's chief compliance officer beginning when the firm first registered in 1994. Div. Ex. 89 at 21-22. Fay was apparently involved in a quasi-legal and compliance type role from 1994 onward.

Bauchle received a bachelor's degree from, and was a student of Max Zavanelli's at, Stetson University; ZPR Investment Research subsequently hired him around 1994.<sup>4</sup> Tr. 139, 142. After two years at ZPR Investment Research, Bauchle began working at ZPRIM, beginning as a trader, then manager of operations, and eventually Vice President, though his duties did not change when he became Vice President. Tr. 142-44. Bauchle was considered "number two" at ZPRIM, behind Max Zavanelli. Tr. 266.

Max Zavanelli terminated Bauchle on April 13, 2013, nine days after the OIP was issued. Tr. 140. Bauchle testified that Max Zavanelli terminated him because he thought Bauchle had made inculpatory statements against ZPRIM and Max Zavanelli during his 2011 testimony in the Commission's investigation into ZPRIM and Max Zavanelli. Tr. 141. He added that Max Zavanelli terminated him by telephone and that Max Zavanelli told him the termination decision was also based upon an issue regarding Bauchle's failure to follow firm billing protocols. Tr. 413-14. Bauchle did not think that his billing practices had been a problem. Tr. 414-15. Max Zavanelli testified that he terminated Bauchle due to multiple factors, including failure to perform duties required of Bauchle's position, stating that he had "gotten lazy;" for making purportedly false statements to the Commission during Bauchle's 2011 investigative testimony; and for defiantly choosing to leave for vacation at a time when ZPRIM was to meet with counsel regarding how to respond to the Division's Wells notice. Tr. 1470-79. Max Zavanelli excoriated Bauchle in a February 18, 2012, email, before ZPRIM received its Wells notice, for "what [Bauchle] said in the deposition." Div. Ex. 102. Bauchle's wife, Amy Bauchle, also worked at ZPRIM between 2005 and April 13, 2013, and resigned the day Bauchle was terminated. Tr. 141. Amy Bauchle performed administrative duties for ZPRIM, including maintaining a log of potential investor contacts and sending out marketing material to potential investors. Tr. 1142, 1428; Resp. Ex. 12.

Bauchle was responsible for maintaining monthly and annual composite calculations. Tr. 177. Bauchle was also responsible for producing daily reports, with returns for each of the securities in the composites, and cash sheets. Tr. 177-78.

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<sup>4</sup> Respondents attempted to paint Bauchle as a "disgruntled" former employee with a grudge to settle for his termination from ZPRIM in April 2013. Tr. 19. As noted infra, particular instances of Bauchle's testimony were not credible. However, his testimony overall was generally believable. Despite a lack of incentive to do so due to his largely retaliatory firing by Max Zavanelli, Bauchle continued to defend some of Max Zavanelli's and ZPRIM's conduct against Division contentions; his 2011 investigative testimony, that was perceived as damaging by Respondents, occurred while he was still employed by ZPRIM; and at several points in his testimony, Bauchle readily admitted to facts that made him look unwise, including admitting that he was incorrect that there had been no notice of an investigation prior to the OIP. See, e.g., Tr. 266-68, 361, 400, 422-23, 437-38. Bauchle has never been the subject of a Commission action or civil suit. Tr. 362-63. His demeanor on the stand was straightforward and matter-of-fact, and he answered questions with nowhere near the evasiveness and discursiveness of Max Zavanelli. See generally infra.

In 2007, David Sappir (Sappir),<sup>5</sup> after meeting Max Zavanelli in 2006 or 2007, created ZPR Client Management, an independent entity wholly owned by Sappir. Tr. 1131-32. ZPR Client Management entered into a contract with ZPRIM in 2007 to provide marketing support to ZPRIM, including soliciting customers to invest with ZPRIM. Tr. 1133-34; Div. Ex. 59. The agreement between ZPRIM and ZPR Client Management provides ZPR Client Management with a thirty percent commission on fees referred to ZPRIM. Tr. 1136, Div. Ex. 59. ZPR Client Management's duties include marketing to potential and prospective ZPRIM clients and maintaining a log of Form ADV delivery and customer contact. Tr. 1140; Div. Ex. 59 at 2. ZPR Client Management's telephone number is typically included as the contact number for ZPRIM in advertisements. Tr. 1141. Sappir acted as the first contact level for ZPRIM's potential customers, and if they were interested, he would forward their contact information to ZPRIM, which would send a package of information to the potential clients. Tr. 1141. ZPR Client Management has no clients other than ZPRIM. Tr. 1134.

#### 4. Mark Zavanelli

Mark Zavanelli received a bachelor's degree from the University of Pennsylvania's Wharton School of Business in 1992. Tr. 1739. After graduating, he worked for ZPRIM for two to three years before leaving to participate in several "entrepreneurial type" activities. Tr. 1297, 1739. In 1998, Mark Zavanelli began working at Oppenheimer Funds as a security analyst, and he rose to become manager to several funds, including its Main Street Fund, which was comprised of large cap investments, and its Main Street Small Cap Fund. Tr. 1739-40. Mark Zavanelli also became the co-head of one of Oppenheimer Funds' investment teams before leaving in 2009. Tr. 1739, 1840. He has received several awards, including being named more than once to Barron's top 100 managers list. Tr. 1741. Mark Zavanelli has been a chartered financial analyst (CFA) since 1997, having completed the courses and tests administered by the CFA Institute. Tr. 1298. He did not collect a salary as an employee of any company between the time he left Oppenheimer Funds in 2009 and when he joined ZPRIM in 2011. Tr. 1840.

### **B. GIPS**

#### 1. Background

GIPS is a set of voluntary ethical standards that investment firms can choose to follow for reporting investment performance results. Tr. 903. It was developed to standardize performance result reporting to provide comparability and facilitate investor confidence in reported returns. Tr. 903; Div. Exs. 25, 26. It is considered a "best practice" in the investment industry. Tr. 903. GIPS is voluntary, but if a firm claims that it complies with GIPS, it has an ethical obligation to follow all of the standards and requirements. Tr. 904. Firms that do not meet all of GIPS'

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<sup>5</sup> Sappir has a bachelor's degree and a master of business administration from the State University of New York at Albany, graduating in 1983 and 1985, respectively. Tr. 1130-31. Prior to opening ZPR Client Management, he was a registered representative of Punk Ziegel, a brokerage firm. Tr. 1131. He previously held Series 7, 24, and 63 licenses, but they have all lapsed. Tr. 1132.

requirements cannot represent that they are in compliance with GIPS. Tr. 938, 1090; Div. Ex. 25 at 16.

The CFA Institute administers GIPS and administered GIPS' predecessor standards, the Association for Investment Management and Research standards (AIMRS). Tr. 441-42, 615-16, 907, 1743-44. GIPS was first published in 1999; it was first amended in 2005 (2005 GIPS Guidelines) and amended again in 2010 (2010 GIPS Guidelines). Tr. 925; Div. Exs. 25, 26. GIPS has become almost mandatory for firms seeking institutional investors. Tr. 904-05. Firms that are not GIPS compliant are unlikely to appear in final searches by institutional investors. Tr. 905.

## 2. Performance Return Calculations, Disclosures, and Reporting

Firms claiming GIPS compliance are required to lump all fee-paying, discretionary accounts into composites that are defined according to investment strategy. Div. Ex. 25 at 10; Div. Ex. 26 at 16. Firms must clearly define their composites and adhere to their definitions as long as they claim GIPS compliance. Tr. 633-34, 978; Div. Ex. 25 at 19; Div. Ex. 26 at 16. Carve-outs—where a firm carves out an asset class from a multiple asset portfolio for which returns are presented as part of a single composite—are permitted, but where a firm claiming GIPS compliance uses carve-outs, it must clearly disclose the policy used to allocate cash to the carve-out returns. Tr. 631-32, 926; Div. Ex. 25 at 19; Div. Ex. 26 at 17, 28.

A fundamental requirement of GIPS is that a firm claiming compliance must make every reasonable effort to provide a compliant presentation of its composites (GIPS-Compliant Presentation) to all prospective clients if it has not done so within the previous twelve months.<sup>6</sup> Tr. 1000; Div. Exs. 25 at 16 (Item 0.A.11 of 2005 GIPS Guidelines), 26 at 14 (Item 0.A.9 of 2010 GIPS Guidelines). A GIPS-Compliant Presentation must include a minimum of five years of annual performance returns calculated according to GIPS. Div. Ex. 25 at 11; Div. Ex. 26 at 20. A GIPS-Compliant Presentation's mandatory disclosures include: the number of portfolios and the amount of assets in each composite; the percentage of total firm assets represented by the composite or the amount of total firm assets at the end of each annual period; benchmark returns; and disclosures about the firm and composites. Tr. 960; Div. Ex. 25 at 22; Div. Ex. 26 at 20. The 2005 GIPS Guideline publication includes sample compliant presentations for firms' use. Div. Ex. 25 at 34-39.

GIPS compliant firms are required to calculate returns quarterly, on an asset weighted basis, with individual portfolio returns weighted quarterly for periods between January 1, 2006, and December 31, 2010, and monthly for periods after January 1, 2010. Tr. 623, 1002; Div. Ex. 25 at 18; Div. Ex. 26 at 16. Returns that are for periods less than one year may not be

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<sup>6</sup> GIPS defines "prospective client" as any person or entity that is qualified to and expresses interest in investing in a strategy. Tr. 1065; Global Investment Performance Standards § V glossary (CFA Inst. 2010). Max Zavanelli referred to prospective investors as those who qualified to invest by having the minimum amount of money. Div. Ex. 89 at 151-52. Once interested investors were deemed qualified, they received the applicable GIPS-Compliant Presentations. Id. at 152.

annualized. Tr. 1073; Div. Ex. 25 at 22; Div. Ex. 26 at 21. Firms may link non-GIPS compliant returns to their compliant returns, but must provide only GIPS compliant returns for periods after January 1, 2000, and the noncompliant returns must follow certain rules set forth in the GIPS guidelines. Div. Ex. 25 at 22; Div. Ex. 26 at 21.

GIPS encourages, but does not require, that firms claiming GIPS compliance be verified by a third-party verifier; however, third-party verification has, practically speaking, become “almost mandatory” within the industry. Tr. 904-05; Div. Ex. 25 at 17; Div. Ex. 26 at 14. GIPS compliance ultimately rests with the firm, even if it chooses to be verified. Tr. 922. The primary purpose of GIPS verification is to ensure that the firm claiming compliance with GIPS has in fact adhered to GIPS and that the firm’s procedures and processes are designed to calculate and present performance results in compliance with GIPS. Tr. 912; Div. Ex. 25 at 29; Div. Ex. 26 at 37. A verification report cannot be provided just for individual composites; it can only be provided for an entire firm. Tr. 912; Div. Ex. 25 at 17; Div. Ex. 26 at 37.

### 3. Advertising Guidelines

GIPS first adopted advertising guidelines on October 1, 2003. Tr. 925-26; Div. Ex. 27. Appendix A to the 2005 GIPS Guidelines and Section III to the 2010 GIPS Guidelines include guidelines for advertising performance returns, modified with each new adoption, for firms that are already GIPS compliant. Div. Ex. 25 at 41-43; Div. Ex. 26 at 35-36. The 2005 GIPS Guidelines’ advertising guidelines define “advertisement” broadly to include

any materials that are distributed to or designed for use in newspapers, magazines, firm brochures, letters, media, or any other written or electronic material addressed to more than one prospective client. Any written material (other than one-on-one presentations and individual client reporting) distributed to maintain existing clients or solicit new clients for an advisor is considered an advertisement.

Div. Ex. 25 at 41. The 2010 Guidelines slightly revised the definition of advertisement to include materials designed for the firm’s website. Div. Ex. 25 at 41; Div. Ex. 26 at 35. The GIPS advertising guidelines are mandatory for any GIPS compliant firm that claims GIPS compliance in its advertisements. Tr. 926, 938; Div. Ex. 25 at 41; Div. Ex. 26 at 35. Item 3 of the GIPS advertising guidelines provides a standardized claim of compliance that must be included in a GIPS compliant advertisement: “[Firm] claims compliance with the Global Investment Performance Standards (GIPS®)” (the Standardized Claim). Div. Ex. 25 at 42; Div. Ex. 26 at 35. The 2005 GIPS Guidelines include sample advertisement formats that firms may follow. Tr. 931-32; Div. Ex. 25 at 44-45.

All advertisements that make a claim of GIPS compliance must include disclosures in accordance with an itemized list in the advertising guidelines Div. Ex. 25 at 41-43; Div. Ex. 26 at 35-36. Relevant to this proceeding are that firms must disclose: a description of how an interested party can obtain a GIPS-Compliant Presentation and/or a list and description of all firm composites (Item 2); the currency used to express returns (Item 8 or 10); which returns are noncompliant, if including returns from periods prior to January 1, 2000 (Item 10 or 12); and

whether performance returns are gross or net of fees (Item 6). Tr. 970; Div. Ex. 25 at 42; Div. Ex. 26 at 35-36. Additionally, advertisements claiming GIPS compliance must, under the 2005 GIPS Guidelines, include either (A) a period-to-date composite return with one, three, and five-year cumulative annualized composite returns, with end-of-period date clearly identified, or (B) five years of annual composite returns, with the end-of-period date clearly identified (Item 5). Tr. 939; Div. Ex. 25 at 42.

The 2010 GIPS Guidelines modified the requirements for performance return reporting in advertisements, requiring either: (A) one, three, and five-year annualized composite returns through the most recent period, with the end-of-period date clearly identified; or (B) period-to-date composite returns on top of one, three, and five-year annualized returns through the same period of time presented in the firm's GIPS compliant presentation, with the end-of-period date clearly identified; or (C) period-to-date composite returns on top of five years of annual composite returns, with the end-of-period date clearly identified (Item 5). Div. Ex. 26 at 36. The 2005 GIPS Guidelines required that advertisements' annualized returns be calculated through the same period as the corresponding GIPS-Compliant Presentation. Div. Ex. 25 at 42. The 2010 GIPS Guidelines, however, allowed firms to provide annualized returns through the most recent period. Div. Ex. 26 at 36. When presenting non-GIPS compliant return information from periods prior to January 1, 2000, the advertisement must specify the figures that are not GIPS compliant and (before 2010) the reason for the non-compliance. Tr. 614-15; Div. Ex. 25 at 42; Div. Ex. 26 at 36.

### **C. ZPRIM's Claims of GIPS Compliance**

ZPRIM began claiming GIPS compliance no later than 2007. Tr. 168, 181, 829, 1726. Max Zavanelli was responsible for ensuring ZPRIM's marketing materials were GIPS compliant. Div. Ex. 89 at 46. There were varying accounts in the testimony about why the firm opted to follow the GIPS guidelines and claim compliance. Bauchle testified that ZPRIM had hired Greg Reed & Associates (Greg Reed), an institutional consultant, in late 2005 to help ZPRIM attract institutional clients. Tr. 184. Greg Reed recommended ZPRIM claim GIPS compliance as it would aid ZPRIM in attracting institutional clients. Tr. 184-85. Max Zavanelli testified that the decision to claim GIPS compliance had nothing to do with attempts to garner institutional investors, though he conceded that Greg Reed had suggested that claiming GIPS would help attract institutional investors. Tr. 1391-92. He testified that he wanted to be compared with other firms to see how he matched up against them; he did not believe that by claiming GIPS, the firm would actually attract new clients. Tr. 1391. He testified that his motive for GIPS-based comparison was to claim "bragging rights." Tr. 829.

From the outset, ZPRIM claimed GIPS compliance for its performance returns reaching back to periods as early as 1987 or 1988. See, e.g., Div. Exs. 117, 118. ZPRIM linked performance returns from prior to January 1, 2001, and included carve-outs in at least one composite. Div. Ex. 89 at 83-86; Div. Exs. 117, 118. The Commission conducted examinations of ZPRIM in 1996 and 2009, and despite concerns by the examination team regarding the issue of carve-outs in pre-2001 performance returns during the 2009 examination, ZPRIM continued to report the early numbers in its advertisements and in its GIPS compliant presentations without disclosing the carve-outs. Tr. 444, 1509; Div. Ex. 89 at 83-86; Div. Exs. 117, 118.

Bauchle became the “point person” for ZPRIM’s GIPS compliance when ZPRIM began claiming GIPS compliance in 2006. Tr. 168, 1392-93, 1557. But his role was limited to being the “numbers guy,” according to Max Zavanelli, and Max Zavanelli had the final say on GIPS compliance. Tr. 836. Bauchle never received any formal training on GIPS. Tr. 183. He familiarized himself with GIPS by reading the GIPS handbook and by working with Ashland, ZPRIM’s first GIPS verifier. Tr. 183. Bauchle understood that a firm had to follow all of the GIPS guidelines when claiming GIPS compliance in advertisements. Tr. 399.

Bauchle testified that ZPRIM maintained “annual disclosure presentations” or “annual disclosure statements” for each composite that were updated each January with the prior year’s figures. Tr. 194-95, 198. ZPRIM’s annual disclosure presentations appear, at least in part, to be the firm’s GIPS-Compliant Presentations, and will be referred to as such.<sup>7</sup> Tr. 194, 961; Div. Ex. 19 at 3; see also Div. Ex. 25 at 22-23; Div. Ex. 26 at 20-21. These presentations were available on ZPRIM’s website until 2010. See, e.g., Resp. Ex. 8 at 22-27. Jean Cabot (Cabot), a Commission exam manager, testified that she believed she reviewed the ZPRIM website during the Commission’s examination in 2009 and that there was an accessible GIPS-Compliant Presentation; and remembered that ZPRIM included a GIPS-Disclosure Presentation on its website. Tr. 730-31, 1057-58. In March 2010, Max Zavanelli directed that ZPRIM stop posting at least the SCV Composite’s full GIPS-Compliant Presentation on its website because he did not want to publicize the composite’s assets. Tr. 373. ZPRIM sent the GIPS-Compliant Presentations to its clients at least once every twelve months. Tr. 373-75; Div. Ex. 89 at 147.

ZPRIM calculated and updated its returns quarterly, though if there had been a particularly strong performance for a month or two, ZPRIM would calculate intra-quarterly. Tr. 194, 221. ZPRIM made its quarterly returns available on its website. See, e.g., Resp. Ex. 8. ZPRIM maintained tables that reported annualized performance returns for one, three, and five-year periods through each quarter, in addition to its quarterly data. Tr. 194; Resp. Ex. 8. The website also included, for certain periods, bar charts, providing visualizations of the firm’s composites’ performance as compared to their benchmarks. Tr. 543-44; Resp. Exs. 9-11.

Interested investors who contacted ZPRIM—usually through ZPR Client Management—were sent a package of marketing materials about the firm. Tr. 1144. Sappir testified that he was not entirely sure what was in the packages, but knew that it consisted of at least a brochure, a letter, and a track record of the firm. Tr. 1144. Sappir testified that he was unsure whether ZPRIM’s GIPS-Compliant Presentation was sent with the initial package, though in his 2011 investigative testimony, he unequivocally stated that it was not. Tr. 1147. Sappir sometimes

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<sup>7</sup> It is not entirely clear whether ZPRIM’s entire annual disclosure presentation comprised its GIPS-Compliant Presentation or just a portion of it. Bauchle referred to the annual disclosure presentation document as a three-page presentation. Tr. 420-21. At one point in the hearing, Max Zavanelli referred to ZPRIM’s annual disclosure presentation’s three pages as the firm’s GIPS-Compliant Presentation. Tr. 1450. Nikola Feliz (Feliz), a senior manager from Ashland, testified that one page of ZPRIM’s three-page annual disclosure presentation was ZPRIM’s GIPS-Compliant Presentation. Tr. 961; Div. Ex. 19.

sent performance tables to interested investors himself, and would tell them that the firm was GIPS compliant. Tr. 1151-53; Div. Ex. 60.

Max Zavanelli testified in 2011 that everyone who qualified as a prospective client received a GIPS-Compliant Presentation “right away.” Div. Ex. 89 at 146. He clarified during the hearing that ZPRIM would send a GIPS-Compliant Presentation to interested investors with a contract, after ZPRIM determined that they qualified as a prospective client. Tr. 1455. Bauchle also testified that prospective clients received a copy of the GIPS-Compliant Presentation. Tr. 210.

Max Zavanelli’s testimony on his level of responsibility for GIPS compliance up until 2011, when Mark Zavanelli took over as chief compliance officer, was inconsistent. He suggested during some of his testimony that all GIPS-related decisions were made by Bauchle with input from Ashland. Tr. 1557. He stated that Bauchle and Ashland made the decisions, but that he “accepted” them, and that he was just kept “informed” on GIPS and advertising issues. Tr. 1527, 1557-58. Earlier testimony by Max Zavanelli, including his investigative testimony in 2011, was more resolute, however; he stated that he had ultimate responsibility for GIPS compliance, and that for GIPS compliance, the “buck stops here.” Tr. 836-37; Div. Ex. 89 at 46. During his investigative testimony, Max Zavanelli told Commission staff that he was “more than familiar” with the 2005 GIPS Standards and that he was “the closest thing to an expert” on GIPS. Tr. 848; Div. Ex. 89 at 42. Later during his investigative testimony, when asked how he authorized a noncompliant advertisement when he was an expert on GIPS, he stated that he was “the closest thing to an expert here,” but that ZPRIM hired Ashland as its expert. Tr. 850; Div. Ex. 89 at 59. Bauchle testified that Max Zavanelli had the final say on running advertisements or newsletters claiming GIPS compliance and for any GIPS compliance claims on ZPRIM’s website. Tr. 186-87. As chief compliance officer prior to Max Zavanelli, Fay had some responsibility for ZPRIM’s GIPS compliance, but for the most part, she left the GIPS issues up to Bauchle and Max Zavanelli. Tr. 1230-32, 1275. Fay testified that she reviewed the GIPS footnotes, but was never involved with reviewing the actual performance returns or presentations for GIPS compliance. Tr. 1230. She rarely communicated with Ashland. Tr. 1275.

ZPRIM continues to claim GIPS compliance. Tr. 1711. Max Zavanelli does not believe that ZPRIM’s running some advertisements that were not GIPS compliant ruins the firm’s ability to claim compliance. Tr. 1726-27.<sup>8</sup>

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<sup>8</sup> In 2008, GIPS published the first error correction policy for GIPS-compliant firms to follow, and updated the policy in 2011. Tr. 406-07, 1060, 1063; Resp. Exs. 40, 41. One of the requirements set forth in the original error-correction policy is that GIPS-compliant firms adopt their own error-correction policies no later than January 1, 2010, and follow them for errors in any GIPS-Compliant Presentation after December 31, 2009. Tr. 406-07, 1062; Resp. Ex. 40 at 6. The GIPS error-correction policy specifically states that it does not encompass advertisement errors. Tr. 406; Resp. Ex. 40 at 3. ZPRIM adopted an error-correction policy in accordance with the guidelines. Tr. 407.

## **D. ZPRIM GIPS Verification**

### **1. Ashland**

Greg Reed recommended that ZPRIM hire Ashland as its GIPS verifier.<sup>9</sup> Tr. 184. ZPRIM hired Ashland in early 2006 to verify its returns for periods between January 1, 2001, and December 31, 2005, and onward. Tr. 186, 906, 1390; Div. Ex. 37. Ashland did not examine or verify any of ZPRIM's returns from prior to 2001. Tr. 962. ZPRIM also hired Ashland to provide performance exams on several of its composites on a quarterly basis. Tr. 912-13. ZPRIM maintained an engagement with Ashland to verify ZPRIM's GIPS compliance on a quarterly basis through the period ended December 31, 2009. Tr. 398, 919. Bauchle was ZPRIM's main contact for Ashland from the original engagement in 2006 through the end of ZPRIM's relationship with Ashland. Tr. 186-87, 924.

Feliz, a senior manager at Ashland, testified for the Division on Ashland and its relationship with ZPRIM.<sup>10</sup> Feliz was involved with ZPRIM's engagement from start to finish, and she communicated with Max Zavanelli on a few occasions. Tr. 924. She communicated with Bauchle mainly, but sometimes spoke to Fay and Max Zavanelli. Tr. 924. In response to claims by Respondents that Ashland wrote the GIPS claim footnote used in ZPRIM's advertisements and GIPS-Compliant Presentations, Feliz did not remember working with ZPRIM on the footnote it used to claim GIPS compliance.<sup>11</sup> Tr. 1070. She conceded that ZPRIM could have spoken to someone at Ashland about footnotes, but she testified that Ashland did not write GIPS footnotes. Tr. 1070-72.

Before beginning its first review, Ashland sent a letter to ZPRIM, asking for certain materials required to complete the verification. Div. Ex. 37. The letter noted that verification is a "continuous" process and Ashland would be providing quarterly reviews to ensure proper firm compliance. *Id.* at 2. The letter also noted that verification would include a review of ZPRIM's marketing. *Id.* at 1. A February 26, 2006, follow-up letter requested ZPRIM's "most recent

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<sup>9</sup> Feliz described Ashland as a member of the AICPA and as the oldest and largest GIPS verification firm in the world, with over 750 clients in twenty countries. Tr. 902.

<sup>10</sup> Feliz has worked at Ashland since graduating from college, beginning as a verifier, and she is currently a senior manager there. Tr. 901, 908. She holds a bachelor's degree in accounting and business administration, and she became a licensed CPA in 2005. Tr. 907. In either 2008 or 2009, she received a certificate in investment performance management, which demonstrates an understanding of the investment business and GIPS. Tr. 907.

<sup>11</sup> Max Zavanelli testified that the language for the footnote in ZPRIM advertisements came from Ashland, including arguably insufficient language describing how to request information from the firm. Tr. 1397. Most of the language required for claiming GIPS compliance in ZPRIM's footnotes is standardized in the GIPS guidelines. Div. Ex. 25 at 16-17, 42; Div. Ex. 26 at 17-18. It is unlikely that Ashland would have advised ZPRIM how to craft the footnote other than to direct ZPRIM to the standardized language found in the GIPS guidelines.

marketing materials” for all ZPRIM composites. Tr. 916-17; Div. Ex. 40 at 3-4. According to Feliz, Ashland requests marketing materials as part of all verifications. Tr. 918. On March 23, 2006, ZPRIM sent Ashland a representations letter, required by Ashland to complete verifications, representing that ZPRIM had provided all of its “performance presentation materials and disclosures” for Ashland’s review, and that the representations were accurate for subsequent periods of verification unless amended or withdrawn. Tr. 919-20; Div. Ex. 40 at 7-8. Feliz testified that Ashland now requires new representation letters for each verification period. Tr. 920-21. Bauchle testified that ZPRIM sent marketing materials, other than advertisements, to Ashland for review every quarter, and Feliz believed that was true. Tr. 389, 1019.

In response to a January 10, 2008, email from Ashland, ZPRIM included a January 2008 Kiplinger magazine advertisement in its marketing material package for Ashland’s verification review. Tr. 927, 935-36, 947, 952; Div. Ex. 21 at 2; Div. Ex. 55. Feliz and Carrie Hoxmeier (Hoxmeier), another member of the Ashland verification team, spoke to Bauchle on the telephone after receiving the advertisement, and explained that they were missing some information required under the GIPS advertising guidelines. Tr. 927-28, 1020. They did not follow up with any written comments. Tr. 1020.<sup>12</sup> Feliz told Bauchle that the advertisement failed to disclose the currency used for the returns, did not clearly disclose how an investor could receive a GIPS-Compliant Presentation,<sup>13</sup> and incorrectly referred to Ashland as ZPRIM’s “auditor.” Tr. 293-94, 928-33, 953. Bauchle believed that ZPRIM removed the word “audited” from its advertisements after and because of Ashland’s comments. Tr. 293-94. Hoxmeier raised the same issue in an April 3, 2008, email to Bauchle, regarding a “flash report,” a one-page marketing piece ZPRIM used. Div. Ex. 64.

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<sup>12</sup> Respondents’ counsel attempted to impeach Feliz’s credibility regarding her memory of this call with answers she gave during her investigative testimony, noting that, during her investigative testimony, she did not recall that Ashland had reviewed any of ZPRIM’s advertisements or had any issues with ZPRIM’s advertisements or marketing materials other than a December 2009 newsletter, discussed infra. Tr. 1026-27. She convincingly explained that she had not reviewed her notes on ZPRIM prior to her investigative testimony because she had no prior notice of what the testimony would be about, and that she only remembered the telephone call with Hoxmeier and Bauchle when her memory was refreshed by reviewing the advertisement and her notes. Tr. 1100-02.

<sup>13</sup> The language regarding this requirement is part of Item 2 in the 2005 GIPS Guidelines, which were applicable to this advertisement. The requirement calls for disclosure on how an interested party can obtain a compliant disclosure “and/or” a list of firm composites. Div. Ex. 25 at 42. Cabot and Feliz contended, in the face of questioning suggesting otherwise, that the language requires disclosure of how a party can obtain either a compliant presentation or a list of composites or both, not that a firm can choose to disclose how to obtain one but not the other. Tr. 701, 930, 1052. Both Cabot and Feliz concede that their interpretations were merely their opinions. Tr. 734, 1053. I find that the plain language of the requirement conforms to Feliz’s and Cabot’s understanding.

ZPRIM never sent any advertisements to Ashland after sending the January 2008 advertisement. Tr. 935-36, 947-48, 972-73. Feliz first saw ZPRIM advertisements other than the January 2008 Kiplinger advertisement when giving investigative testimony in 2011. Tr. 935. Feliz testified during the hearing that, had Ashland been shown ZPRIM's other advertisements, Ashland would have discussed with ZPRIM the problems Feliz identified. Tr. 946-47. She represented that, had ZPRIM promptly corrected the problems in its advertisements, ZPRIM could have continued to claim GIPS compliance. Tr. 947. However, if Ashland continued to receive erroneous advertisements from ZPRIM, despite warnings of compliance issues, Ashland would likely have been unable to continue the verification process. Tr. 947, 973-74.

Bauchle agreed that after January 2008 the firm did not send advertisements to Ashland before running them. Tr. 419-20. However, he did not recall receiving an objection to the January 2008 advertisement from Ashland. Tr. 290-91, 293. He testified that format changes to the April 2008 advertisement in SmartMoney were "probably" at Max Zavanelli's direction, and removal of the word "audited," starting with the October 2008 advertisement, was at Ashland's direction. Tr. 292-94. He further testified that he did not send any advertisements to Ashland after January 2008, even after they were run, because it was not ZPRIM's "procedure to send them every ad." Tr. 419. This was because of "timing constraints," in that advertisements had to be submitted to magazines so far in advance that the listed performance data was not always up to date. Tr. 289, 419-20. He testified that Max Zavanelli had final say on whether to run advertisements. Tr. 421.

However, Bauchle told Cabot, both during the examination and while preparing for his hearing testimony, that ZPRIM stopped sending advertisements to Ashland when its performance declined, as Max Zavanelli wanted. Tr. 517-19. Max Zavanelli admitted during investigative testimony that he did not believe ZPRIM was required to provide its advertising to Ashland, and to his knowledge, ZPRIM did not. Div. Ex. 89 at 49. Bauchle's explanation to Feliz as to why Ashland was not receiving ZPRIM's advertising was that it did not intend to continue advertising after January 2008. Tr. 936, 947-48, 973. Fay, the chief compliance officer at the time, was apparently unaware that ZPRIM should have sent advertisements to Ashland; she sent an email to Ashland following the Commission's examination, conveying the Commission's recommendation to send the advertisements and asking whether Ashland believed doing so was necessary. Resp. Ex. 13. Fay testified that she never heard Max Zavanelli instruct Bauchle not to send additional advertisements to Ashland. Tr. 1275, 1288.

Max Zavanelli's testimony on this point was confusing, inconsistent, and evasive. In his investigative testimony he stated that Bauchle did not tell him that Ashland had an issue with ZPRIM's marketing materials. Tr. 1701. Similarly, he initially testified at the hearing, when questioned by his counsel, that Bauchle never informed him of the issues Ashland had raised regarding the January 2008 Kiplinger advertisement. Tr. 1394-96. However, a short time later he testified that Bauchle did tell him, in late April or May 2008, after the April 2008 advertisement ran, that there were problems with all of the 2008 advertisements, and that Bauchle told him the footnote had to "greatly expand." Tr. 1397, 1405. Later yet, he testified that Bauchle instead told him that there would be only one correction to the footnote, to remove the word "audited." Tr. 1405-06. Max Zavanelli admitted, however, that ZPRIM "added three entire new lines to the footnote." Tr. 1406. Although Max Zavanelli initially testified that he put

together the format, and Ashland wrote the new footnote language, he later testified both that Ashland “did the format for us” and “approved” the format. Tr. 1394-95, 1397, 1406, 1697-98. He could not recall telling Bauchle to forward advertisements to Ashland, and could not remember any advertising being forwarded, other than the January 2008 advertisement. Tr. 1696-97. However, in his investigative testimony he stated that he did not know whether Ashland reviewed ZPRIM’s advertising. Tr. 1700. His understanding was that ZPRIM was not required to give its advertisement materials to Ashland, even though Ashland requested them. Tr. 1697-98. In his view, once Ashland found the format acceptable, ZPRIM did not need to send each advertisement to Ashland. Tr. 1698. In his investigative testimony, he also stated that Ashland was not required to receive ZPRIM’s advertising, but when asked about this testimony at the hearing, he gave multiple non-responsive answers. Tr. 1701; Div. Ex. 89 at 54. He testified both that “I know” Bauchle gave Ashland ZPRIM’s marketing materials “every quarter,” and then moments later changed his mind and said he did not know that. Tr. 1702, 1704.<sup>14</sup>

## 2. Deterioration of ZPRIM’s Relationship with Ashland

In November 2008, Ashland sent ZPRIM an email attaching a list of comments generated from its review of ZPRIM’s website, which included GIPS compliant presentations for its composites. Tr. 199; Div. Ex. 47. Ashland took particular notice of two of ZPRIM’s investment report newsletters for October and November 2008. Div. Ex. 47. The comments included concerns that ZPRIM had listed performance returns with a claim of GIPS compliance without including all of the information required by the GIPS advertising guidelines. Tr. 199-200; Div. Ex. 47. Ashland suggested that if ZPRIM decided to continue to claim GIPS compliance in the investment report newsletters, ZPRIM would need to either include the required information from the GIPS advertising guidelines or attach a copy of its GIPS compliant presentations for the composites. Div. Ex. 47. During Ashland’s review of ZPRIM’s second quarter 2009 returns, it

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<sup>14</sup> Although the evidence plainly and overwhelmingly demonstrates that ZPRIM failed to send its advertisements to Ashland after January 2008, more scrutiny is required to determine whether that failure was intentional. I conclude that it was intentional, and I do not credit Bauchle’s testimony on this point. His explanation at the hearing for not forwarding advertising to Ashland—that the advertising could not be prepared in time—is not convincing, because Ashland was conducting quarterly reviews, not monthly reviews, and transmitting advertising was thus generally not urgent. By contrast, Cabot testified that Bauchle admitted, both during ZPRIM’s examination and right before the hearing, to intentionally withholding advertisements from Ashland (at Max Zavanelli’s direction), and Feliz testified that Bauchle told her (falsely) that ZPRIM did not intend to run advertisements after January 2008. Max Zavanelli admitted during the investigation that he did not believe ZPRIM had to provide its advertising to Ashland, and to his knowledge, ZPRIM did not. Div. Ex. 89 at 49, 54. Fay’s testimony is of little help, except to demonstrate her lack of compliance oversight. In view of Max Zavanelli’s inconsistency and evasiveness on this subject, and his admission that he did not think he had to provide advertising to Ashland, I credit the testimony of Cabot and Feliz, and conclude that Max Zavanelli directed Bauchle to stop sending advertising to Ashland, and to provide Ashland a plausible, but false, explanation.

again informed Bauchle by letter that the investment report newsletter for June 2009 reported performance returns and would have to follow GIPS guidelines. Div. Ex. 48. Sometime in late 2009, Ashland contacted Bauchle and told him to send ZPRIM's GIPS-Compliant Presentation to everyone on the monthly investment report newsletter distribution list.<sup>15</sup> Tr. 206-07; 1449. Without consulting Max Zavanelli, Bauchle sent a copy of ZPRIM's GIPS-Compliant Presentations to everyone who received a copy of the recent investment report newsletter. Tr. 206-07. Bauchle testified that Max Zavanelli was upset that Bauchle sent out the GIPS-Compliant Presentations because Max Zavanelli did not want to reveal the composites' asset levels. Tr. 207-08. Max Zavanelli's unhappiness with the decision to send the firm's GIPS-Compliance Presentation to everyone on the investment report newsletter distribution list was evident in an article he included in ZPRIM's December 2009 investment report newsletter (December 2009 Newsletter). Div. Ex. 9 at 4.

Max Zavanelli and Feliz spoke to each other by telephone around the end of 2009, after Ashland saw a copy of the December 2009 Newsletter, part of which claimed GIPS compliance. Tr. 991, 1449; Div. Ex. 50. During that conversation, Feliz told Max Zavanelli that the newsletters should be considered advertisements and that ZPRIM should either follow the advertising guidelines or attach GIPS-Compliant Presentations. Tr. 956-57. Max Zavanelli explained that he did not believe that the investment report newsletters were considered advertisements because they were not, in his mind, marketing material. Tr. 1451-52. He added that he did not believe the investment report newsletters were being provided to prospective clients, as the term is defined in the GIPS guidelines, and thus the GIPS advertising guidelines would not apply. Tr. 1449, 1453. He provided the newsletters to members of the investment community to keep them apprised of his activities and strategies as well as current market events and predictions. Tr. 1439. He argued that the non-client recipients would never be interested in investing with ZPRIM and thus a GIPS-Compliant Presentation did not need to be provided. Tr. 1438. Max Zavanelli told Feliz that he did not want to include a GIPS-Compliant Presentation with the investment report newsletter because it would be burdensome and because he did not want the general public to see how small the firm was. Tr. 956-57, 1449-50. Feliz disagreed with Max Zavanelli and told him that he either needed to comply with the GIPS advertising guidelines or attach GIPS-Compliant Presentations going forward, if claiming GIPS compliance. Tr. 993. At the end of the telephone conversation, Max Zavanelli asked Feliz to provide some options for ZPRIM to follow for the future. Tr. 993.

Max Zavanelli said Ashland's concerns about his investment report newsletters were based upon criticisms that he made about GIPS in his December 2009 newsletter, which, according to Max Zavanelli, upset Ashland. Tr. 830, 1449; Div. Ex. 9; Div. Ex. 89 at 36, 38. In that newsletter, he included an article in which he criticized the GIPS requirement to report asset-weighted returns. Div. Ex. 9 at 4. He characterized his December 2009 newsletter comments in his 2011 investigative testimony as a "political mistake." Tr. 831; Div. Ex. 89 at 35. Feliz testified that the concern with the December 2009 newsletter was that ZPRIM made a claim of GIPS compliance on reported performance returns without following the GIPS advertising

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<sup>15</sup> Bauchle testified that this occurred in 2008, but the December 2009 investment report newsletter discusses the issue as though it had recently occurred. I find that Bauchle's claim that it occurred in 2008 was an error, and that it occurred in 2009.

guidelines. Tr. 1081-82. The article itself was not noncompliant with GIPS, because it made no claim of compliance. Tr. 1082. Feliz, however, was concerned with Max Zavanelli's article on GIPS because it seemed to display an intent to flout certain GIPS requirements in the future, and as the firm's GIPS verifier, Ashland had a responsibility to ensure the firm's ongoing GIPS compliance. Tr. 991-92.

Feliz and Toby Cochrane (Cochrane), the Ashland partner assigned to ZPRIM, held a follow-up telephone call with Max Zavanelli in March or April 2010. Tr. 993-94, 1451. Feliz's recollection of the call was strikingly different from Max Zavanelli's. Feliz testified that Max Zavanelli said his "team had brought him more up to speed on GIPS compliance" and that he agreed to comply with whatever options Ashland provided. Tr. 994. Max Zavanelli, in contrast, testified that the Ashland staff "didn't seem to know about" the 2005 GIPS Standards' 0.A.11, governing the provision of compliant presentations to all prospective clients and "had no response" to his comments about it, and that he had "won the debate." Tr. 1451-52, 1456. Feliz sent a letter after the call providing two options for how ZPRIM's investment report newsletters could comply with GIPS. Tr. 994-95; Div. Ex. 52. The undated letter was addressed to Bauchle and Feliz believes it was sent in March or April 2010. Tr. 995; Div. Ex. 52. The two options presented were for ZPRIM to either cease claiming GIPS compliance in the newsletters or follow the GIPS advertising guidelines. Tr. 998-1003; Div. Ex. 52.

Max Zavanelli testified that the first time he saw the letter from Feliz was during his investigative testimony in 2011. Tr. 1457. He said that when he asked Bauchle to call and find out why Ashland was resigning, that Bauchle did so and reported that the newsletter triggered the resignation, and that Bauchle never told him anything about the letter he received from Ashland.<sup>16</sup> Tr. 1457-58. By contrast, during the investigation, Max Zavanelli testified that Ashland did not tell him why it resigned (see *infra*), that he never spoke to anyone at Ashland about it, and that he suspected Ashland resigned because it received a Commission subpoena, but that he did not actually know. Div. Ex. 89 at 32, 34, 38. He testified that he would have chosen the first option in the letter, removing all mention of GIPS. Tr. 1458. Feliz did not know whether Max Zavanelli received the letter, but believes, based on subsequent conversations she had with Bauchle, that Bauchle received it. Tr. 1087.

As part of its next verification review, Ashland requested recent marketing materials from ZPRIM, including a recent investment report newsletter. Tr. 1004. Feliz received an investment report newsletter and determined that it did not comply with either option provided in Ashland's letter. Tr. 1004. Feliz brought the issue of ZPRIM's failure to comply with Ashland's guidance to Mel Ashland, the managing partner of Ashland. Tr. 1004. He determined that it would be best for Ashland to resign as ZPRIM's verifier. Tr. 1004. On July 9, 2010, Ashland sent a letter to ZPRIM notifying the firm that it was terminating its relationship as ZPRIM's GIPS verifier, citing its inability to reach a "necessary level of comfort which would allow [Ashland] to continue to attest to the firm's claim of GIPS compliance." Tr. 209, 1005; Div. Ex.

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<sup>16</sup> It is utterly implausible that Ashland would have sent the letter had Max Zavanelli "won the debate" on the telephone, and I accord no credit to his testimony on that point, or to his testimony that Bauchle never told him about the letter.

36. Feliz testified that she has been involved with over 400 clients during her tenure at Ashland, and ZPRIM was the only client she could recall Ashland terminating. Tr. 1006-07.

Ashland completed its verification of ZPRIM's GIPS compliance through the final quarter of 2009. Tr. 975; Div. Ex. 36. Though Ashland terminated its relationship with ZPRIM in mid-2010, it did not perform any verification services for periods in 2010. Tr. 975.

### 3. Alpha

Following Ashland's resignation, ZPRIM engaged Alpha Performance Verification Services (Alpha) in November or December 2010 to perform third-party verification reviews for the periods ended December 31, 2010, onward. Tr. 398; Div. Ex. 89 at 31, 161. Alpha verified ZPRIM's GIPS compliance for the period ended December 31, 2011, but no evidence was introduced that Alpha verified ZPRIM's GIPS compliance for 2012. Resp. Ex. 22.

## **E. Commission Examination and Investigation**

### 1. Onsite Examination and Document Review

The Commission conducted an examination of ZPRIM that included an onsite inspection at ZPRIM's Orange City, Florida headquarters between February 3, 2009, and February 13, 2009.<sup>17</sup> Tr. 444. Cabot, joined by staff examiner Jesse Alvarez, led the examination.<sup>18</sup> Tr. 444, 492. The examination team requested and reviewed documents related to the firm's business activities, disclosures, and books and records. Tr. 444-45. They also interviewed Bauchle, Fay, and, on a limited basis, Max Zavanelli. Tr. 445. Among the materials requested were all emails among Max Zavanelli, Bauchle, and Fay. Tr. 1243; Resp. Ex. 42 at 30. The examination team uncovered several deficiencies at ZPRIM, including inadequate GIPS compliance. See Div. Ex. 77.

Cabot testified for the Division regarding the examination. She found ZPRIM cooperative during the examination, responsive to the examination team's requests, and forthright in their answers. Tr. 523. The examination team did not find that ZPRIM had provided them with any incorrect performance return numbers. Tr. 681. Cabot testified that she discussed some of the GIPS-related issues in the advertisements with Max Zavanelli and that he

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<sup>17</sup> The Commission examined ZPRIM once before in 1996. Tr. 1509-10.

<sup>18</sup> Cabot earned a bachelors of science degree in business administration from Bryant College and a master of business administration from Nova Southeastern University. Tr. 439. Cabot is a certified fraud examiner, and she previously took and passed the first level of the CFA designation exams. Tr. 442-43. She worked at Franklin Templeton as a performance analyst, working to ensure that its offices, globally, were compliant with AIMR and then GIPS. Tr. 441. She joined the Commission in 2003, first as an examiner, and became an exam manager in 2011. Tr. 440-41. Her examinations of investment advisers include GIPS compliance reviews, if the firm claims GIPS compliance. Tr. 440.

was defensive. Tr. 488-90. Her interaction with Max Zavanelli was very brief, and she had no recollection of speaking with him in detail about the GIPS deficiencies the examiners discovered. Tr. 724-25. However, she distinctly remembered discussing with Max Zavanelli ZPRIM's false claims in its advertisements that Ashland had audited the firm for GIPS compliance. Tr. 508, 724.

Prior to concluding the onsite examination, Commission staff, including Cabot, conducted an exit interview with Bauchle and Fay, and the staff made certain deficiencies known at that time. Tr. 736. One finding relayed to ZPRIM was that it should send all of its advertisements to Ashland for review. Tr. 431; Div. Ex. 77. Fay relayed Cabot's recommendation in an email to Ashland on February 17, 2009. Tr. 1270; Resp. Ex. 13. Fay testified that ZPRIM ceased advertising after the exit interview until November 2009, while it considered the Commission's comments. Tr. 1270-71.

Fay testified that after the exit interview, she typed up her notes on the issues raised by Commission staff and informed Max Zavanelli of the findings shortly thereafter (he was not present for the exit interview, except possibly for a portion in the morning). Tr. 1254, 1259. Max Zavanelli did not remember when he spoke to Fay about the exit interview, but believed that it would have been shortly after its conclusion. Tr. 1254.

## 2. Deficiency Letter

The examination team sent a deficiency letter to ZPRIM on January 28, 2010 (Deficiency Letter), regarding the problems uncovered during the examination.<sup>19</sup> Tr. 475-76; Div. Ex. 77. The Deficiency Letter stated, in relevant part, that: (1) ZPRIM's SCV Composite may have included improper periods of returns that did not "benefit the investment strategy of the Composite"; (2) a December 2008 SmartMoney performance advertisement failed to comply with GIPS advertising guidelines; (3) ZPRIM's January 2009 investment report newsletter failed to comply with GIPS advertising guidelines and made an inaccurate claim that its performance returns had been "audited," when the firm's GIPS compliance had only been "verified"; and (4) ZPRIM's January and February 2008 performance return advertisements in Kiplinger had incorrectly stated that ZPRIM's performance returns had been "audited," when the firm's GIPS compliance had only been "verified." Div. Ex. 77.

## 3. ZPRIM's Response to the Deficiency Letter

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<sup>19</sup> Ashland learned that the Commission would be conducting an examination of ZPRIM sometime in 2009. Tr. 978-79. At one point, Fay reached out to Ashland regarding questions posed by the examination staff regarding ZPRIM's compliance and Ashland's verification. Tr. 979; Resp. Ex. 13. As part of ZPRIM's representation letter on March 23, 2006, ZPRIM represented that it would provide Ashland with findings and related correspondence by regulatory agencies. Tr. 980; Div. Ex. 40 at 7-8. ZPRIM never provided the Deficiency Letter that it received in January 2010 to Ashland. Tr. 981; Div. Ex. 77.

Fay and Max Zavanelli drafted and sent a response to the Deficiency Letter (Response) on February 26, 2010. Tr. 491; Div. Ex. 78. The Response attempted to explain the SCV Composite's use of carve-outs, and it stated that going forward, the composite would either exclude the carve-outs or add appropriate disclosure. Div. Ex. 78 at 2.

The Response represented that ZPRIM and Max Zavanelli were unaware that the GIPS guidelines required one, three, and five-year annualized returns, disclosure of the currency, or a description of the composite's benchmark, noting, "[w]e wonder why Ashland Partners did not mention this during their verification process."<sup>20</sup> Tr. 985; Div. Ex. 78 at 2-3. It also represented that it would correct the deficiencies going forward. Div. Ex. 78.

Cabot testified that, although ZPRIM represented that it would make corrections in response to the examination team's findings, several of the deficiencies were not corrected. Tr. 491; Div. Ex. 78. For example, in advertisements run after the Response, ZPRIM reported performance returns with no period-to-date numbers and ZPRIM also claimed that its returns had been audited instead of verified. Tr. 491-92.

#### 4. Commission Investigation of ZPRIM

On August 16, 2010, the Division sent ZPRIM a letter notifying it that the Commission was conducting an investigation of ZPRIM. Tr. 252; Div. Ex. 92. The letter requested, pursuant to Advisers Act Rule 204-2, that ZPRIM produce certain documents by September 1, 2010. Div. Ex. 92. The letter enclosed a Form 1661, Supplemental Information for Regulated Entities Directed to Supply Information Other Than Pursuant to a Subpoena. Id. Additional letters requesting documents were sent to ZPRIM on October 27, 2010, and November 30, 2010. Id. These additional letters explained that the Commission was conducting an investigation of ZPRIM. Id. The August 16, 2010, letter was addressed to Max Zavanelli, but the latter two letters were addressed to counsel for ZPRIM, indicating that it had hired counsel by that point to assist it with its responses to Commission staff. Id. Commission staff took the investigative testimony of Max Zavanelli on June 13, 2011, Bauchle on October 14, 2010, and Feliz on February 22, 2011. Tr. 258, 837, 1013, 1101, 1143, 1168, 1249; Div. Exs. 88, 89, 155. Commission staff also took testimony of Fay and Sappir. Tr. 258, 1142.

Bauchle participated in the document production in response to the August 16, 2010, letter and subsequent requests. Tr. 170. According to Bauchle, all of ZPRIM's communications were produced in accordance with the requests, but, as discussed infra, documents from the ZPR Portals were not produced. Tr. 172-73. The Commission issued a Wells notice to ZPRIM in May 2012. Tr. 1312, 1467.

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<sup>20</sup> This comment was at best disingenuous; Ashland had alerted ZPRIM in November 2008 to ZPRIM's failure to include a disclosure of currency and a description of the composite's benchmark. Tr. 233; Div. Ex. 47.

## **F. ZPRIM's Magazine Advertisements**

### **1. Early Advertisements**

ZPRIM began running magazine advertisements in 2006. Tr. 187-88. The original magazine template was designed with Ashland's help, according to Bauchle, and it included year-by-year performance returns, back to 2001, and period-to-date information. Tr. 187-88. Advertisements in SmartMoney in January and April 2008 reported year-by-year performance returns for the SCV Composite between 2001 and September 30, 2007, for the January advertisement, and December 31, 2007, for the April advertisement, in addition to compounded returns for the seven and twenty year periods ended at the same respective dates. Div. Ex. 21 at 1, 4. ZPRIM also ran advertisements in Kiplinger in January and February 2008, which both reported performance returns for the SCV Composite between 2001 and September 30, 2007, in addition to compounded returns. Id. at 2-3.

### **2. Fall 2008 Magazine Advertisements**

In October, November, and December 2008, ZPRIM ran advertisements in SmartMoney, reporting its performance returns. Div. Ex. 21 at 5-8. Each of these advertisements included a footnote with the standard format GIPS advertising compliance claim, "ZPR Investment Management claims compliance with the Global Investment Performance Standards (GIPS®)." Id.; see also Div. Ex. 25 at 42. The advertisements were placed with SmartMoney as part of a three-advertisement package deal that ZPRIM purchased. Tr. 1408.

The October 2008 SmartMoney advertisement reported ten-year compounded and annualize returns for ZPRIM's SCV Composite for the period through June 30, 2008, for its SCV Composite as compared to its two benchmarks. Div. Ex. 21 at 6. According to these returns, the SCV Composite had outperformed its benchmarks. Id. The November 2008 SmartMoney advertisement included the same performance returns for the SCV Composite as the October 2008 SmartMoney advertisement, but with returns through August 31, 2008. Id. at 7. According to these returns, the SCV Composite had outperformed its benchmarks. Id. The December 2008 SmartMoney advertisement reported compounded, but not annualized, performance returns for the SCV Composite for five, ten, and twenty-year periods through September 30, 2008.<sup>21</sup> Div. Ex. 21 at 5. According to these returns, the SCV Composite had outperformed its benchmarks. Id.

As the Division alleges in the OIP, as found by examination staff during the 2009 exam, and as admitted by Respondents and Bauchle, none of the October, November, or December 2008 SmartMoney advertisements provided returns through the same period as any GIPS-Compliant Presentations for the SCV Composite, nor did any provide period-to-date returns. Tr. 196, 214-15, 478, 939; Div. Ex. 21 at 5, 6, 7. None of the three ads include one, three, or five-

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<sup>21</sup> The returns were incorrectly reported in the December 2008 SmartMoney advertisement as being through August 31, 2008; the numbers were actually reflective of returns through September 30, 2008. Tr. 480. The incorrect data was an error by the formatter of the advertisement. Tr. 404, 1415.

year annualized returns. Tr. 214-15, 939; Div. Ex. 21 at 5, 6, 7. Accordingly, the October, November, and December 2008 advertisements failed to comply with the GIPS advertising guidelines in the 2005 GIPS Guidelines, the applicable standards at the time of the advertisements. Tr. 214-15, 939; Div. Ex. 21 at 5, 6, 7.

Cabot testified that, had ZPRIM followed the GIPS advertising guidelines and reported performance returns for the stub periods between January 1, 2008, and June 30, August 31, and September 30, 2008, the advertisements would all have shown that ZPRIM's SCV Composite "significantly underperformed" the Russell 2000 Index. Tr. 478-481. Cabot testified that, instead, ZPRIM chose reporting periods that reflected more favorable returns to the firm. Tr. 485-86. Cabot recalculated the SCV Composite returns for the periods that GIPS required the advertisements to include period-to-date returns. Tr. 480. She calculated that the SCV Composite's return for the period January 1, 2008, to June 30, 2008, was -17.02% and the Russell 2000 Index's return for the same period was -9.38%. Tr. 483. She determined that the SCV Composite's return for the period January 1, 2008, to August 31, 2008, was -12.7% while the Russell 2000 Index's return was -2.63% for the same period. Tr. 485. She determined that the composite's performance return for January 1, 2008, through September 30, 2008, was -18.42% whereas the Russell 2000 Index's return for the same period was -10.39%. Tr. 481.

Bauchle agreed with Cabot that the 2008 advertisements would have shown the SCV Composite's negative performance, had they complied with the GIPS advertising guidelines. Tr. 189-90. Bauchle emailed Max Zavanelli on April 8, 2013, after the OIP was issued, informing him that the advertisements would have shown that the SCV Composite was underperforming the benchmark if they had followed the GIPS advertising guidelines. Tr. 865-66; Div. Ex. 116. The advertisement format was changed, according to Bauchle, to avoid publicizing the firm's poor returns. Tr. 188-89. Max Zavanelli conceded that had the 2008 advertisements complied with GIPS, they would have shown that the SCV Composite's one-year return was underperforming its Russell 2000 Index benchmark. Tr. 1502, 1679. Max Zavanelli conceded that ZPRIM changed its advertising format to exclude annual returns after knowing that ZPRIM's performance at the time was poorer than its benchmarks, although he initially maintained that he did not personally approve or know about the changes in format until after the advertisements had run. Tr. 1500-02.

Bauchle testified that the information showing performance through each quarter was available on the website, and that would have shown the firm's underperformance of its benchmark. Tr. 364-65, 409. Additionally, Bauchle believed that all prospective clients that requested information received GIPS-Compliant Presentations that reflected the returns through the prior year's end. Tr. 407-08. ZPRIM also sent a one-page fact sheet with the firm's standard package to potential investors that included periodically updated performance return information. Tr. 376-78. An example of the fact sheet sent in August 2008 to a potential investor shows SCV Composite returns through the first quarter of 2008, which reported ZPRIM's poor performance for its prior year and year to date, including ZPRIM's underperformance of the Russell 2000 Index. Tr. 379; Resp. Ex. 11 at 3.

Bauchle testified that he expressed concern to Max Zavanelli about the advertisements' failure to comply with GIPS in August or September 2008, when Max Zavanelli wanted to

change the format of the advertisements by switching to annualized returns rather than year-by-year returns, as ZPRIM had used in the past. Tr. 193, 402-03; see also Div. Ex. 21 at 1-4. Bauchle was particularly concerned that the advertisements would have to include one, three, and five-year returns, which Max Zavanelli's plans did not include, and he discussed this concern with Max Zavanelli prior to ZPRIM publishing the October 2008 advertisement. Tr. 225, 401. Bauchle expressed a similar concern to Sappir and Fay in September 2008 concerning posting performance returns on ZPRIM's website, stating "[s]omething is sticking in my head that you need to show 1, 2, 3 and 5 year Annualized performance." Div. Ex. 142. Bauchle stated during the hearing that Max Zavanelli dismissed Bauchle's concerns because, Max Zavanelli reasoned, investors would receive a GIPS-Compliant Presentation with all of the required information if they contacted the firm. Tr. 225-26, 402-04. Bauchle testified that he brought the issue to Fay and told her that the advertisements with revised return periods were not compliant with GIPS, but that the two decided that they had to follow Max Zavanelli's direction. Tr. 204-05. Cabot testified that Bauchle had told her the same thing during the Commission's examination. 486-88, 490. Bauchle did not know whether Fay relayed his concerns to Max Zavanelli. Tr. 205. According to Cabot, Bauchle and Fay told her they knew the advertisements were not GIPS compliant, but the advertisements ran anyway at Max Zavanelli's direction. Tr. 488.

Max Zavanelli disputed Bauchle's account of the creation of the advertisements and the events transpiring afterward, factors that led in part to his decision to terminate Bauchle's employment. E.g., Tr. 1408-15. His own account of events was confusing and inconsistent, however. Max Zavanelli testified that he had purchased a three-advertisement package deal, and that he had told Bauchle that he wanted to run advertisements similar to the April 2008 SmartMoney advertisement,. Tr. 1408-10. He provided Bauchle with draft advertisements in the same format as the April 2008 advertisement, which included year-by-year annual performance returns, but also included period-to-date returns. Tr. 1409; Div. Ex. 21 at 4; see also Resp. Ex. 46 at 2, 4. He testified that Sappir and Bauchle chose a format different from the one he drafted, without his knowledge, and he attempted to bolster this claim by pointing to a July 16, 2008, email exchange between Sappir and Bauchle in which Bauchle selected a format similar to what was used in the October 2008 advertisement, instead of a format similar to the April 2008 advertisement. Tr. 1410, 1414-15; Resp. Ex. 46. Max Zavanelli claimed that he was not a recipient of that email exchange, and that, prior to when the fall 2008 advertisements ran, he was not shown the advertisement format Sappir and Bauchle chose. Tr. 1410. He testified that the first time he saw the October, November, and December 2008 advertisements was during the Commission examination, when Cabot pointed out to him that two of the advertisements had the same return date, but different returns. Tr. 1415-16.

Contradicting his own account, Max Zavanelli testified during both the investigation and the hearing that the advertisements were edited on the eve of the October 2008 advertisement, because of a last-minute call from the formatter they hired for the advertisement, telling them that the advertisement was too long. Tr. 1418-19; Div. Ex. 89 at 55, 140. Max Zavanelli testified that he was traveling around the time he received the call about having to chop the advertisements due to their length, and that "unfortunately, I made the approval without thinking

and these ads got out.”<sup>22</sup> Tr. 1418-19; Div. Ex. 89 at 62. He said “no way” to cutting the footnote with the claim of GIPS compliance and verification. Tr. 1419. Max Zavanelli said that he should have tried to make it fit to comply with GIPS, but he “sort of lost control” and “forgot the format was wrong.” Div. Ex. 89 at 140. Also, Max Zavanelli said during his investigative testimony that Sappir did not “create anything,” he only provided input, and that he, not Sappir, was “absolutely” responsible for creation and distribution, which contradicts his hearing testimony that Sappir and Bauchle selected the advertisement format. Tr. 1486; Div. Ex. 89 at 29.

In addition to claiming that the first time he saw the October, November, and December 2008 advertisements was during the 2009 examination, he testified at the hearing that he was never informed that there were serious problems with any of the advertisements until ZPRIM received the Deficiency Letter in 2010. Tr. 1433, 1446. During his investigative testimony, however, he testified that Bauchle informed him that the December 2008 advertisement was not GIPS compliant after it had been published, and that upon review of the advertisement, Max Zavanelli determined that the October and November 2008 advertisements were also not GIPS compliant. Div. Ex. 89 at 47, 59. Also, as noted, Max Zavanelli denied in his investigative testimony that Bauchle ever told him that Ashland had any problems with ZPRIM’s marketing materials or advertisements, but during the hearing he said that Bauchle told him in April or May 2008 that Ashland said that they needed to remove the word “audited” from the footnote and “greatly expand the footnote.” Tr. 1397; Div. Ex. 89 at 49.

Max Zavanelli also denied that he had a conversation with Cabot about the GIPS issues in the advertisements, other than Cabot’s pointing out inconsistent returns. Tr. 1415-16, 1418.

Fay disputed Bauchle’s testimony regarding when she was told there were problems with the 2008 advertisements. Tr. 1267. She testified that she had no knowledge of problems with the 2008 advertisements prior to the Commission’s examination team raising the issues with her in 2009. Tr. 1264-65. Fay claims that she had no discussions with either Bauchle or Max Zavanelli on GIPS issues in the 2008 advertisements before the advertisements were run. Tr. 1266-67. Fay testified that, after the Commission’s examination staff raised the issues with her, she contacted Ashland for the first time about the advertisements. 1268-69. An email from Fay to Ashland staff on February 17, 2009, after the examination had concluded, asked Ashland questions arising from issues raised by the examination staff. Tr. 1269; Resp. Ex. 13. However, the email does not discuss issues raised by the examination staff regarding the October, November, and December 2008 advertisements. Resp. Ex. 13. Fay testified that she had telephone conversations with Ashland during the course of the examination regarding some of the issues raised by the examination staff regarding the October, November, and December 2008 advertisements. Tr. 1276.

Fay testified that she first learned about the issues with ZPRIM’s advertisements during the examination. Tr. 1264-65. She had been unaware that there was an issue with use of the term “audited” in the footnote regarding Ashland’s verification, or that there was a problem in

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<sup>22</sup> Bauchle, by contrast, testified that he did not remember the length of the advertisement ever being a problem. Tr. 403-04.

the lack of one, three, and five-year returns in certain advertisements. Tr. 1261-64. She claimed that she was unaware how the term “audited” came to be removed from advertisements after the April 2008 SmartMoney advertisement. Tr. 1263. Fay understood that Ashland verified ZPRIM’s performance returns, but was unaware that they reviewed any advertisements. Tr. 1272. She did not recall any conversations about Ashland’s comments on ZPRIM’s January 2008 SmartMoney advertisement. Tr. 1274-75. She testified that ZPRIM did not run advertisements between the examination and November 2009, in order to assure compliance. Tr. 1277.

Bauchle and Max Zavanelli both testified that the fall 2008 advertisements failed to generate any new ZPRIM clients; Max Zavanelli said that the advertisements were a “disaster.” Tr. 358, 1427-29.

### 3. 2011 Magazine Advertisements

ZPRIM began reporting its performance returns to Pensions & Investments magazine on a regular basis in 1991, so that it could be compared against peer money managers. Tr. 1463. In its November 15, 2010, issue, Pensions & Investments named ZPRIM top performing manager in three categories: Global Equity Composites, 1 Year Return; Global Equity Composites, 5 Years Annualized Return; and International Equity Composites, 1 Year Return. 1460; Resp. Ex. 15. In its February 21, 2011, issue, Pensions & Investments named ZPRIM leading manager in three categories: World Stock Composites, 1 Year Return; World Stock Composites; 5 Years Annualized Return; and International Equity Composites, 1 Year Return. Tr. 1460; Resp. Ex. 17. ZPRIM wanted to reprint the tables from Pensions & Investments in its advertisements, and it approached the magazine about doing so. Tr. 1460. Pensions & Investments and ZPRIM entered into a contract to reprint the table, but the contract required that ZPRIM reprint the tables exactly as they were published in Pensions & Investments. Tr. 1462; Resp. Ex. 21. ZPRIM published the November 15, 2010, tables in an advertisement run in the February 2011 issue of SmartMoney. Tr. 1460; Resp. Ex. 15. ZPRIM ran a similar advertisement with the February 21, 2011, tables in the May 2011 issue of SmartMoney. Tr. 1460; Resp. Ex. 17. ZPRIM ran the same advertisement with the February 21, 2011, tables in the March 21, 2011, issue of Barron’s. Resp. Ex. 19. ZPRIM sent the February and May 2011 SmartMoney and Barron’s advertisements to Pensions & Investments magazine to ensure that they complied with that publication’s requirements. Tr. 1462. ZPRIM made claims of GIPS compliance in the three advertisements, but did not provide the advertisements to anyone, including Pensions & Investments, for review of GIPS compliance. Tr. 1661.

The Pensions & Investments tables reprinted in the February and May 2011 SmartMoney advertisements and March 21, 2011, Barron’s advertisement showed that ZPRIM reported the highest gross return percentages within each category. Resp. Exs. 15, 17, 19. ZPRIM’s advertisements also included Morningstar ratings for the ZPR Global Equity Composite as well as for three, five, and ten-year returns, and overall returns. Resp. Exs. 15, 17, 19. All of the advertisements included one and five-year performance returns for the ZPR Global Equity Composite, but no three-year returns; it also included one-year performance returns for the ZPR All Asian Composite, but no three or five-year returns. Resp. Exs. 15, 17, 19. According to Max Zavanelli, the return percentages reflected annualized returns. Tr. 1670-72.

Max Zavanelli stated that he did not include the three-year performance returns for the Global Equity Composite, or the three or five-year returns for the All Asian Composite, because of the requirements in the agreement with Pensions & Investments not to alter the tables. Tr. 1460; Resp. Ex. 21. Additionally, ZPRIM did not have information on the other listed money managers' performance returns for other years, and including more years' worth of returns for ZPRIM composites would be an incomplete comparison. Tr. 1565, 1670. He conceded, however, that ZPRIM added the footnote with all of the claims of GIPS compliance, the ZPRIM logo, the Morningstar ratings, and language about account minimums to the February and May 2011 SmartMoney advertisements and the March 21, 2011, Barron's advertisement—all of which were done without disturbing the Pensions & Investments tables. Tr. 1504-05, 1663, 1668.

Additionally, the advertisements, contrary to GIPS' requirements, showed gross returns instead of net returns. Tr. 1461. Max Zavanelli explained that reporting gross, rather than net, returns is the industry standard, because institutional investors can often negotiate their own fee rates. Tr. 1461-62. Max Zavanelli added that a footnote to the tables informed readers that net return information was available on ZPRIM's website. Tr. 1463; Resp. Exs. 15, 17, 19. Max Zavanelli approved the 2011 advertisements, with the claims of GIPS compliance. Tr. 1503.

Max Zavanelli averred that claiming GIPS compliance in the 2011 advertisements was to convey that the firm was GIPS compliant—not to convey that the advertisements were GIPS compliant. Tr. 1661.

#### 4. Additional Advertisement Issues

In addition to the GIPS compliance failures in the 2008 and 2011 advertisements alleged in the OIP, the Division established at the hearing that twenty of twenty-one advertisements ZPRIM published between January 2008 and April 2010, all making claims of GIPS compliance, failed to comply with GIPS.<sup>23</sup> Tr. 936; Div. Ex. 21 at 1-11 and 13-21. None of the twenty advertisements correctly provided information on how to receive a GIPS-Compliant Presentation from ZPRIM, which is required by the GIPS advertising guidelines' Item 2. Tr. 602, 627, 936-37; Div. Ex. 21 at 1-11 and 13-21; Div. Ex. 25 at 42; Div. Ex. 26 at 36. None of the twenty advertisements complied with Item 8 of the 2005 GIPS Guidelines advertising guidelines, requiring that the advertisement identify the currency of the reported returns. Tr. 608-13, 627, 937; Div. Ex. 21 at 1-11 and 13-21; Div. Ex. 25 at 42.

Feliz testified that, in addition to the ubiquitous lack of currency disclosure and information on how to receive a GIPS-Compliant Presentation in ZPRIM's advertisements, several of the advertisements also failed to include mandatory performance returns. For example, a January 2010 SmartMoney advertisement and two January 2010 Barron's advertisements for ZPRIM's Global Equity Composite and one January Barron's advertisement

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<sup>23</sup> A January 2010 ZPRIM advertisement in SmartMoney did not make a claim of GIPS compliance. Div. Ex. 21 at 12.

for ZPRIM's SCV Composite failed to include one-year annualized returns, as GIPS required; instead, they included only one-year compounded returns. Tr. 943; Div. Ex. 21 at 13-16. Feliz conceded that one-year compounded returns for ZPRIM could have been the same as one-year annual returns, but the fact that the returns were not labeled as annual is itself contrary to GIPS' requirements. Tr. 1073-75.

Cabot testified that several advertisements, including the October, November, and December 2008 SmartMoney advertisements, failed to disclose whether performance return numbers from prior to 2000 were calculated using methods other than those required under GIPS, as required by Item 10 of the advertising guidelines. Tr. 614-19. Cabot also faulted the advertisements between January 2008 and April 2010, which reported on the SCV Composite, for failure to follow ZPRIM's own definitions of its SCV Composite in calculating and reporting performance returns. Tr. 635. Feliz testified that if the firm added accounts to the composite that did not comport with the composite definition, the returns would not comply with GIPS. 976-78. Cabot also criticized ZPRIM for failure to disclose the use of carve-outs in the advertisements as GIPS required.<sup>24</sup> Tr. 635. The examination staff conveyed these issues to ZPRIM in the Deficiency Letter. Tr. 634; Div. Ex. 77. ZPRIM represented in its response letter that it would correct the problems. Div. Ex. 78.

Feliz testified on the 2011 SmartMoney and Barron's advertisements' non-compliance with the GIPS advertising guidelines. The March 21, 2011, Barron's advertisement lacked disclosure of the currency used in the performance returns, as required by Item 8 of the GIPS advertising guidelines, and failed to properly inform interested investors where they could obtain a GIPS-Compliant Presentation, as required by Item 2 of the GIPS advertising guidelines.<sup>25</sup> Tr. 968; Div. Ex. 7. The February and May 2011 SmartMoney advertisements include the same failings. Tr. 970-71; Div. Exs. 6, 66.

ZPRIM ran advertisements in November and December 2009 in SmartMoney that included one, three, and five-year annualized returns, but failed to include period-to-date returns, as required by the advertising guidelines in the 2005 GIPS Guidelines. Div. Ex. 21 at 8-9; see Div. Ex. 25 at 42. Max Zavanelli testified that he purposely left out the period-to-date returns in these advertisements because he knew that the 2010 GIPS Guidelines would rid advertisers of

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<sup>24</sup> Cabot claimed that Item 10 of the GIPS advertising guidelines required disclosure of the use of carve-outs in performance returns. Tr. 635. Though Item 4.A.11 of the 2005 GIPS Guidelines required disclosure of the use of carve-outs, Item 10 of the advertising guidelines does not explicitly require disclosure in the advertisements. Div. Ex. 25 at 42.

<sup>25</sup> The requirement for currency disclosure became Item 10 in the advertising guidelines in the 2010 GIPS Guidelines. Div. Ex. 26 at 36. According to Feliz, the advertising guidelines from the 2005 GIPS Guidelines still applied to the three 2011 advertisements because the returns advertised were for periods ending no later than December 31, 2010. Tr. 967-68. According to Feliz, the 2010 GIPS Guidelines only affect presentations that include returns for periods after December 31, 2010. Tr. 967; Div. Ex. 26 at 9.

the requirement, and that he was adopting “best practices” under GIPS by following the new guidelines ahead of time.<sup>26</sup> Tr. 1432, 1434.

### **G. Investment Report Newsletters**

ZPRIM sent its monthly investment report newsletters to clients, academics, institutional investors, journalists, family members, and friends, among others. Tr. 1438. Max Zavanelli testified that he and ZPRIM have been sending them out for over twenty years. Tr. 1437. He contends that his investment report newsletters are unique among the investment industry, and that ZPRIM works at getting its returns out quickly, which makes it difficult to provide fully GIPS-compliant returns. Tr. 1445; Div. Ex. 89 at 40. Max Zavanelli testified that compiling data for the investment report newsletters was a team effort, but that he wrote the majority of the content. Tr. 1437-38.

ZPRIM sent an April 2009 investment report newsletter (April 2009 Newsletter) to its distribution list, which reported performance returns for the prior month for the SCV and EQTP Composites, among others. Resp. Ex. 23 at 3. The reported returns included positive results for the prior month’s SCV, EQTP, All Asian, and Global Equity Composite returns. Id. at 2-3. The discussion added that the EQTP’s one-year return was negative, but better than its S&P 500 Index benchmark. Id. at 2. The newsletter did not include one-year returns for the SCV, All Asian, or Global Equity Composites. Id. at 3-4. The newsletter also discussed the impact of the “uptick” rule that had recently been in the news, and included data on how the uptick rule affected the SCV Composite. Id. at 5. The purpose of discussing the impact of the rule change was to “explain [ZPR’s] performance,” why the firm was “getting killed.” Tr. 1441. Max Zavanelli testified that he wanted to show people “why we’re losing money, why we’re making money.” Tr. 1442. The April 2009 Newsletter included a footnote at the end of the performance return descriptions that made a claim of GIPS compliance, and stated that Ashland had verified its returns. Id. at 4. The April 2009 Newsletter, however, failed to include disclosures required by the GIPS advertising guidelines, including period-to-date returns and three and five-year annualized returns for the EQTP Composite or one, three, or five-year returns for the SCV, All Asian, and Global Equity Composites. Resp. Ex. 23.

A December 2009 investment report newsletter (December 2009 Newsletter) included tables from the November 16, 2009, issue of Pensions & Investments, which ranked ZPRIM’s International Global Equity Composite first among world stock composites for one-year returns and sixth for five-year returns, and the SCV Composite seventh among “composite U.S. value stock” for five-year returns. Resp. Ex. 24 at 4. The two world stock composite tables provide

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<sup>26</sup> I do not credit this testimony, because the 2010 GIPS Guidelines were not published until March 29, 2010, well after the November and December 2009 advertisements were submitted to, and published by, Smart Money. Div. Ex. 26 at 2. Although it is theoretically possible that Max Zavanelli could have been aware in 2009 of the planned 2010 GIPS Guidelines’ option to drop period-to-date returns, there is no record evidence explaining how he gained such awareness, and in any event, Ashland took the position that firms could not do what Max Zavanelli claimed he had done. Tr. 967.

ZPRIM's International Global Equity Composite's one and annualized five-year gross returns, but not net returns, and the composite U.S. value stock table provides one-year gross and net returns for the SCV Composite. *Id.* The December 2009 Newsletter states, below the Pensions & Investments tables, that "[a]ll numbers are GIPS compliant." *Id.* Additionally, the newsletter discussed returns for the SCV, EQTP, All Asian, and Global Equity Composites' monthly results. *Id.* at 2-3. The December 2009 Newsletter did not include period-to-date returns for any of the composites and did not include one or three-year returns for the SCV Composite, three-year returns for the Global Equity Composite, or one, three, or five-year returns for the All Asian or EQTP Composites. Resp. Ex. 24.

Max Zavanelli conceded that the April and December 2009 newsletters had normal GIPS compliance language, and that neither complied with the GIPS advertising guidelines. Tr. 1694. He testified that ZPRIM was not attempting to mislead anyone with the investment report newsletters; rather, ZPRIM intended to provide information to investors as fast as possible. Tr. 1445. ZPRIM sent the newsletters out on the first day of each month, and it took at least ten days to perform the complex calculations necessary under GIPS because the firm could not determine asset weightings any faster. Tr. 1444-45. Max Zavanelli makes this point in ZPRIM's December 2009 Newsletter, in an article he wrote criticizing certain GIPS requirements. Tr. 1444; Resp. Ex. 24 at 5. The article specifically stated that the "investment report you are now reading is not GIPS compliant." *Id.* Max Zavanelli testified that the claim of GIPS compliance on the page with the Pensions & Investments tables pertained only to the fact that the performance returns were calculated in accordance with GIPS. Tr. 1443; Resp. Ex. 24 at 4.

Additionally, as he had argued to Ashland, Max Zavanelli believed that the investment report newsletters were not advertising materials and that the GIPS advertising guidelines did not apply. Tr. 1438-39.

#### **H. Morningstar Reports**

According to Bauchle, ZPRIM began providing information to Morningstar in approximately 1998 to attract institutional investor clients. Tr. 249-50. In 2005 Morningstar expanded access to its database beyond institutional investors. Tr. 249-51. Bauchle made the decision to provide information to Morningstar. Tr. 250.

According to Max Zavanelli, ZPRIM began providing information to Pensions & Investments in 1991, at Max Zavanelli's direction and before Bauchle began working there, because Pensions & Investments maintained performance data on institutional managers. Tr. 1463-64, 1577. At some point, Morningstar purchased the data compilation feature, and thereafter ZPRIM gave its information to Morningstar, which forwarded it to Pensions & Investments. Tr. 1463-64.

Bauchle and Max Zavanelli agreed that Bauchle was responsible for submitting data to Morningstar, and that there was no fee for doing so. Tr. 249-550, 259, 1579. Bauchle submitted the data quarterly. Tr. 1579. After ZPRIM referred to Morningstar's positive star ratings in an advertisement, Morningstar contacted ZPRIM and informed it that it would have to pay Morningstar for references. Tr. 269, 1464. ZPRIM then entered into a contract with

Morningstar that allowed it to refer to Morningstar “star” ratings in its advertisements. Tr. 269, 1465; Resp. Ex. 35. Bauchle was the only person at the firm with login credentials to access the Morningstar portal. Tr. 269-70, 1466, 1808. Max Zavanelli did not have the login password, Bauchle was not aware of Max Zavanelli ever accessing the Morningstar portal, and Max Zavanelli testified that he never used Morningstar himself. Tr. 269-70, 277, 1466, 1581.

Max Zavanelli’s testimony on this point was not credible. He admitted that he had been in the financial industry since the 1970s. Tr. 1589. But he contended that prior to 2011, he was unaware that investors had access to the data that ZPRIM, or other firms, sent to Pensions & Investments and Morningstar; he said he did not know that the information ZPRIM submitted went anywhere other than Morningstar’s database. Tr. 1578-79, 1589. He knew that Morningstar rated money managers, but apparently thought because Morningstar reports were marked “not for distribution,” that others did not have access to the information. Tr. 1577-80. He testified that he learned only upon signing the contract with Morningstar in 2011 that the data was available to subscribers, and that he had previously never inquired of Morningstar regarding who had access to the information, or directed anyone else to do so. Tr. 1578, 1580, 1588-89. He testified that the purpose of submitting information to Morningstar was to measure ZPRIM’s performance against everyone else, to win awards, and to “possibly” show he was a great manager. Tr. 1577, 1581. The awards, in turn, were used in ZPRIM’s advertising. Tr. 1581. However, he also testified that he had never read a Morningstar report until “after he saw them in exhibits,” that he did not read Morningstar reports on companies he was researching, and that he had never visited Morningstar’s website. Tr. 1581-82, 1586, 1589. Later he testified both that he had never read a “complete” report until 2011, and that he could not recall reading a complete report. Tr. 1585-86. In fact, he received a seven-page March 31, 2011, Morningstar report by email on May 12, 2011. Div. Ex. 157. He initially denied providing information to Morningstar for the purpose of gaining institutional clients. Tr. 1587. He later admitted that the purpose of the Morningstar reports was to provide information to potential institutional investors to compare advisers. Tr. 1688-89. Max Zavanelli testified that ZPRIM never gained institutional clients as a result of the information it provided to Morningstar. Tr. 1587.

During the hearing, Mark Zavanelli explained Morningstar’s different products and how they were interconnected. ZPRIM paid for a Morningstar “Essentials” license, which allowed ZPRIM to download Morningstar reports regarding ZPRIM, provide those reports to third parties, and use the Morningstar ratings assigned to ZPRIM in its advertisements. Tr. 1795-96. The Essentials license had a separate login protocol from the other Morningstar products. Tr. 1795-96. To access reports on other managers, Morningstar requires a separate, premium subscription, known as Morningstar Direct, which is mostly for institutional investors. Tr. 1798-99; Div. Ex. 37. Morningstar Data Manager is the portal, accessible only with unique login information, which firms, including ZPRIM, use to update their data. Tr. 1800-01. Data Manager is what Bauchle used to update Morningstar on ZPRIM. Tr. 1801. Updates could be made manually or automatically, with software to provide quick updates. Tr. 1801.

Prior to 2011, when ZPRIM signed an agreement with Morningstar, it was not ZPRIM’s policy to send Morningstar reports to clients or prospective clients, but Max Zavanelli conceded that reports could have been sent to them prior to that time without his authorization. Tr. 1633,

1687. Indeed, Sappir sent Morningstar reports to some prospective clients as early as 2008. Tr. 1636, 1644-45; Div. Exs. 153, 154.

A thirteen-page September 30, 2010, Morningstar report for ZPRIM's SCV Composite stated that Ashland had audited ZPRIM's GIPS-compliant performance returns. Div. Ex. 10. That statement was incorrect because Ashland was never ZPRIM's auditor (it was its GIPS verifier), and at that time Ashland had already resigned as ZPRIM's GIPS verifier. Tr. 1690. ZPRIM also had not hired Alpha yet and had no GIPS verifier at the time, and none of the data past the period ended December 31, 2009, had been verified. Tr. 1690. The statement was also incorrect because Ashland never audited any returns. Tr. 1691-92. Mark Zavanelli testified that he believed that a seven-page Morningstar report for September 30, 2010, which included a watermark prohibiting distribution, was a "teaser" report that money managers could view without paying for the full report. Tr. 1802-03; Resp. Ex. 25. The seven-page report also reported no Commission investigation and that Ashland had verified ZPRIM's performance returns "to the present." Resp. Ex. 25.

A seven-page version of the March 31, 2011, Morningstar report stated that performance returns had been audited by Ashland from 2000 "to the present."<sup>27</sup> Div. Ex. 11 at 2. Bauchle told Max Zavanelli in an email that the "to the present" language was mistakenly left over from prior reports, and that he mistakenly failed to update it to reflect the fact that Ashland had resigned. Resp. Ex. 27. He did not include fiscal period end dates in that section of the Morningstar updates as a practice because he was afraid that he would forget to do an update to reflect each report's end date. Resp. Ex. 27. A thirteen-page version of the March 31, 2011, Morningstar report for ZPRIM's SCV Composite also stated that there was no Commission investigation, but differed from the seven-page version by stating that Alpha had verified ZPRIM's performance returns from December 31, 2009, to December 31, 2010, and that Ashland had verified the returns between December 31, 2000, and December 31, 2009. Tr. 1809; Resp. Ex. 26 at 10. Mark Zavanelli did not know the reason for the disparity between the seven and thirteen-page March 31, 2011, Morningstar reports, but surmised that Bauchle might have updated the Morningstar database. Tr. 1810-11, 1835. Bauchle did not have an explanation for the discrepancy, except that it "surprise[d]" him. Tr. 282-83.

The thirteen-page September 30, 2010, Morningstar report and the seven-page March 31, 2011, Morningstar report for ZPRIM's SCV Composite state that there was no Commission investigation pending. Tr. 253-55, 1692; Div. Exs. 10, 11. Bauchle testified that he answered the question of Commission investigations in the negative because he believed that the investigation was not formal until after the OIP issued on April 4, 2013. Tr. 255-56. He testified that after receipt of letters from the Commission during the period of its investigation, the firm held meetings where ZPRIM staff would "downplay" the investigation's significance; thus the box for pending investigation was not checked. Tr. 285. Bauchle was unaware that ZPRIM received a Wells notice, and testified that he was unfamiliar with the term. Tr. 413. After having his memory refreshed, Bauchle testified that he knew in October 2010, when he gave his investigative testimony, that there was "a formal SEC investigation" at the time. Tr. 435-38.

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<sup>27</sup> The OIP makes no allegations regarding this incorrect statement.

Minutes from an August 30, 2010, ZPRIM board meeting state that ZPRIM had received a letter from the Commission, had retained counsel, and was gathering documents to respond to the Commission's "inquiry." Tr. 1220; Div. Ex. 81. Max Zavanelli agreed that ZPRIM was aware of the Commission investigation when the Commission sent its August 16, 2010, letter, and that ZPRIM had hired counsel at that point. Tr. 772, 1220; Div. Ex. 92. He agreed that the Commission took testimony of ZPRIM staff in 2010, including Bauchle's in October 2010, and that counsel was assisting the firm prepare for that testimony. Tr. 773-74. As noted, he received a copy of the March 31, 2011, seven-page Morningstar report on May 12, 2011. Div. Ex. 157. He testified that he never instructed Bauchle not to check the box indicating the firm was under investigation. Tr. 1466. He testified that he first learned that Morningstar had a "pending SEC investigation" box when ZPRIM received the Wells notice, in 2012. Tr. 1467.

Max Zavanelli's testimony on this point was otherwise not credible. He was the subject of a Commission investigation in the 1980s, and thus must have known what was going on in 2010. Resp. Ex. 32. Nonetheless, he testified that the "Pending SEC investigations: no" entries in the two Morningstar reports were true at the time because ZPRIM had not yet received a Wells notice. Tr. 767, 1692-93.<sup>28</sup> But he also testified, just moments after testifying differently, that he knew in August 2010 that there was an investigation. Tr. 767, 773. He was provided with a copy of the formal order of investigation when he gave testimony in June 2011. Div. Ex. 89 at 177.

When I questioned him about how he would have answered the Morningstar question regarding "pending SEC investigation," had he been the one to do so, his answers were evasive and inconsistent with his previous testimony. First, he said he would have consulted National Compliance Services (NCS), a compliance firm ZPRIM began working with after Mark Zavanelli took over as chief compliance officer, that is, at a time well after the events in question. Tr. 1713. Next, he said he would have consulted with his lawyers. Tr. 1714. Finally, he said he would have checked the "no" box, not because he had a sincere belief that "no" was the right answer, but because he understood that if "yes" is checked, the Morningstar portal requires specification of "what are the charges, what's the date," which were not applicable at the time. Tr. 1714. Although he admitted that he never accessed Morningstar, he testified that his son asked Morningstar about this in 2013, and they said that if there are no charges, then the "no" box should be checked.<sup>29</sup> Tr. 1714-15.

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<sup>28</sup> The transcript records him as saying that ZPRIM received the Wells notice in 2010; this is clearly a typographical error. Tr. 1692.

<sup>29</sup> Mark Zavanelli did not testify about an inquiry made to Morningstar. In any event, it seems highly unlikely that Morningstar would require this, because the target of an investigation may not know the tentative charges, and indeed, no charges may ever be filed. See generally BDO China Dahua CPA Co., Ltd., Initial Decision Release No. 553, 2014 WL 242879, at \*4-\*47 (Jan. 22, 2014) (describing various Commission investigations). In this case, for instance, the Commission's August 16, 2010, letter discloses no tentative charges and explicitly states that it "should not be construed as an indication by the Commission or its staff that any violation of law has occurred." Div. Ex. 92.

After the April 4, 2013, OIP was issued, Bauchle reported the initiation of a Commission proceeding in the Morningstar reporting database, and screen shots from Morningstar's website entry for ZPRIM reflect Bauchle's update disclosing the OIP. Tr. 284-85; Resp. Ex. 38.

### **I. Post-2011 Compliance**

Prior to joining ZPRIM, Mark Zavanelli's compliance experience was limited to his dealings with Oppenheimer Funds' compliance department while working as a fund manager there. Tr. 1740, 1840. He familiarized himself with GIPS by reading the standards and guidelines. Tr. 1746-47. He also familiarized himself with ZPRIM's books and records by reviewing them, and familiarized himself with the company, generally, by speaking with employees, including Bauchle and Fay. Tr. 1748. He knew when he joined ZPRIM there were issues with the firm's GIPS compliance that had been flagged by the Commission. Tr. 1750. He attended a seminar by Investment Advisers Watch in preparation for his role as chief compliance officer, although he admitted that the seminar was not "too in depth." Tr. 1746. Max Zavanelli testified that he believed his son was qualified for the chief compliance officer position, despite a lack of compliance experience, because of his experience at Oppenheimer Funds and his energy, skill, and talent. Tr. 1618-19.

Mark Zavanelli began acting as ZPRIM's chief compliance officer in October 2011. Tr. 1744. Subsequently, he reviewed ZPRIM's practices, identified certain GIPS-related problems, and pointed out many of them to his father. Tr. 1222. Since becoming chief compliance officer, Mark Zavanelli has been responsible for working with Alpha and NCS. Tr. 1319, 1618. Mark Zavanelli conceded that he was not an experienced chief compliance officer, but ZPRIM chose to rely on NCS for compliance issues beyond his expertise, in consideration of minimizing ZPRIM's expense. Tr. 1841-42.

When Mark Zavanelli first arrived at ZPRIM, he provided copies of ZPRIM's investment report newsletters to NCS, and probably Alpha, to review. Tr. 1765-66, 1771. In consultation with NCS and Alpha, he determined that the newsletters were advertising that reported performance returns. Tr. 1766. He sent an email to Max Zavanelli informing him that he had reviewed the definition of advertisements in GIPS, and determined that it included the investment report newsletters. Tr. 1316; Div. Ex. 133. Mark Zavanelli decided that ZPRIM should attach tables to the investment report newsletters going forward, containing performance returns that comply with the advertising guidelines for each composite. Tr. 1528-31, 1766; Div. Exs. 137, 138. He changed the policy over Max Zavanelli's objections. Tr. 1526, 1773. The December 2012 investment report newsletter shows that by that point, ZPRIM was attaching the GIPS advertising compliant tables. Tr. 1768; Resp. Ex. 30.

Mark Zavanelli learned that Max Zavanelli had for years included all accounts in the SCV Composite, rather than only those that qualified under the composite definition. Tr. 1223-24. He told Max Zavanelli in an email that those numbers did not comply with GIPS, but that because the GIPS guidelines permitted use of older numbers in performance returns, they could continue including them. Tr. 1324; Div. Ex. 134. Mark Zavanelli consulted with Alpha regarding how to deal with the pre-2001 numbers and determined that ZPRIM would have to

either disclose the non-compliance, or drop the pre-2001 numbers, or restate the pre-2000 returns to comply with the GIPS guidelines. Tr. 1324, 1760-62; Div. Exs. 117, 134. Max Zavanelli disagreed with Mark Zavanelli's analysis and argued that the pre-2000 numbers were GIPS compliant. Tr. 1324, 1331; Div. Exs. 134, 135. Over Max Zavanelli's objection, Mark Zavanelli decided to eliminate ZPRIM's use of pre-2000 numbers in the SCV Composite's performance returns. Tr. 881, 1536-37; Div. Exs. 117, 118, 128.

Mark Zavanelli testified that the compliance process for advertisements has been bolstered since he arrived at ZPRIM, and that he has made changes to the firm's website, brochures, and investment report newsletters, and to its GIPS footnote. Tr. 1755-56, 1763-64. To begin with, he had NCS perform a review of the firm's website and its investment report newsletters. Tr. 1753. He also engaged Alpha on the firm's marketing and GIPS compliance and made changes in response to Alpha's comments. Tr. 1754-55. A snapshot taken of ZPRIM's website in August 2013 shows that the website, which Mark Zavanelli concedes is itself an advertisement, claims GIPS compliance and includes one, three, and five-year returns for the SCV and Global Equity Composites. Tr. 1757-58; Resp. Ex. 29. It also shows that ZPRIM no longer advertises its performance returns from prior to January 1, 2001. Tr. 1758-59.

Additionally, Mark Zavanelli has modified the firm's advertising format and has asked Alpha to review advertisements before they run. Tr. 1776-77. Mark Zavanelli or staff at his direction will have responsibility for uploading data to Morningstar, now that Bauchle is no longer with ZPRIM. Tr. 1800-01.

Mark Zavanelli claims that he was unaware that the Commission was conducting an investigation into ZPRIM until it received the OIP. Tr. 1299-1300. He testified that he was aware that ZPRIM employees, including Max Zavanelli, had provided testimony to the Commission, and that ZPRIM had hired counsel. Tr. 1301-02. He conceded that those facts made him aware that the Commission's involvement with ZPRIM was more than a "routine thing," but maintained that he was unaware that the examination phase had progressed into an investigation. Tr. 1301. Though he read the transcripts from Commission testimony, he did not "recognize the verbiage" of the investigation at the beginning of each transcript. Tr. 1300. On October 8, 2012, Mark Zavanelli sent Bauchle an email to update the firm's submissions to Morningstar, and he told Bauchle that he should mark "No" for the question asking whether there were any pending Commission investigations. Tr. 1308-09; Div. Ex. 132. He believed at the time that it was the correct answer. Tr. 1309. He also told Bauchle to mark "Yes" to "SEC investigations in last 5 years." Div. Ex. 132. His explanation for this apparent inconsistency was that he had "maybe" understood the term "investigation" to refer to the 2009 examination. Tr. 1309-10.

Mark Zavanelli testified that he had learned of several significant issues during the hearing that he would go back and address. Tr. 1844. For example, he had not performed a review of the ZPR Portal emails for the annual compliance review; he represented that he would do so in the future. Tr. 1816.

## **J. Books and Records and Electronic Communications**

### **1. The First ZPR Portal**

In approximately 2002 or 2003, Max Zavanelli invested in building ZPR International's first portal (First ZPR Portal), a cloud-based research support database and an internationally networked communication hub, so that he and his businesses could communicate and share research from anywhere globally. Tr. 146, 1378. The First ZPR Portal was Internet-based, accessible at [www.zprinternational.net](http://www.zprinternational.net), and required a login and password for access.<sup>30</sup> Tr. 182.

The First ZPR Portal had many technological drawbacks. Communications were archived on the server, but could not be saved to a personal account; the only methods for preserving single communications was to print off hard copies or forward them to an email address. Tr. 173-74, 335, 1383-84.

A former student and employee of Max Zavanelli, Richard Bigot (Bigot), a French and Thai citizen, built the First ZPR Portal. Tr. 332, 1383. Bigot remained the First ZPR Portal's webmaster and hosted the server, maintaining complete administrative control. Tr. 333, 1385-86. According to Max Zavanelli, Bigot became greedy and attempted a "major coup," which included perpetration of fraudulent acts and stealing funds, and, as a result, Max Zavanelli terminated the contract with Bigot in around March 2011. Tr. 1384. According to Max Zavanelli, Bigot threatened to steal the First ZPR Portal away from Max Zavanelli even before their relationship ended. Tr. 1384-85.

After the contract with Bigot was ended, Bigot did not return the portal's archived data, including communications, to ZPRIM. Tr. 1384. On March 1, 2011, ZPR International sent a letter to Bigot (March 2011 Letter) confirming his contract's termination and demanding that he release control and deliver the First ZPR Portal assets to ZPR International within seven days, but Bigot disregarded the demand. Tr. 332-33, 1514-15; Resp. Ex. 44. Max Zavanelli testified that he has brought a civil lawsuit against Bigot and that there is a pending criminal action against him as well, but they do not appear to address recovery of the First ZPR Portal. Tr. 1514-15. Max Zavanelli testified that since the March 2011 Letter, he has not taken any further action to recover the contents of the First ZPR Portal. Tr. 1516.

According to Max Zavanelli, Bigot maintained the First ZPR Portal in Thailand and France, which Max Zavanelli said makes recovery of the data difficult. Tr. 1385. ZPRIM and its employees could no longer access the First ZPR Portal after Bigot's contract ended. Tr. 333-35; 1385. Respondents cited Bigot's lack of cooperation and ZPRIM's inability to recover the

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<sup>30</sup> A dispute arose at the hearing over the identity of the electronic address "ZPRPortAdmin," and whether it indicated the sender was sending a message through the ZPR Portal. The best explanation provided was that it did not reflect a ZPR Portal communication; rather, ZPRPortAdmin was short for ZPR Portfolio Administrator and was a ZPRIM email address used to send the firm's information packets to potential investors after they had spoken with Sappir. See, e.g., Tr. 166, 349, 424; Resp. Exs. 11, 18, 20. Amy and Ted Bauchle were the most frequent users of the address. Tr. 349, 383, 667; Resp. Ex. 11.

First ZPR Portal data for not producing materials from the First ZPR Portal, in response to the Trial Subpoena. Tr. 316.

## 2. The Second ZPR Portal

In 2011, after Bigot threatened to abscond with the First ZPR Portal data, Max Zavanelli built a new portal (Second ZPR Portal). Tr. 1385-86. The Second ZPR Portal serves the same purposes as the First ZPR Portal, but is more technologically advanced than the earlier version; notably, it is able to catalogue and save all messages for individual user access. Tr. 1387. The Second ZPR Portal is hosted on a server located in Lithuania. Tr. 149, 327. Vaidotas Petrauskas, ZPR International's research manager, who also performs some services for ZPRIM, maintains the Second ZPR Portal. Tr. 797. The Second ZPR Portal went live in March 2011, and Petrauskas sent a message on March 25, 2011, informing ZPR Portal users that use of the portal provided better security than traditional email. Tr. 799-800; Div. Ex. 108. He also included instructions for accessing the Second ZPR Portal. Div. Ex. 108. The Second ZPR Portal requires a login and password, as the First ZPR Portal did. *Id.* The Second ZPR Portal's address is [www.zprintl.com](http://www.zprintl.com), and the syntax for user communications consists of the employee's name followed by a slash and "zpr@zpr.com," so for example, Max Zavanelli's ZPR Portal address is [maxzavanelli/zpr@zpr.com](mailto:maxzavanelli/zpr@zpr.com). Tr. 162, 334, 744-45.

## 3. ZPR Portal Usage

Max Zavanelli used the ZPR Portal as his primary method of communicating with ZPRIM and ZPR International employees. Tr. 1517-20. He believed that he had been assigned an email on the ZPRIM email system, but he never used it. Tr. 1647. The ZPR Portals permitted communication among his multiple companies that were scattered globally. Tr. 1381. He may or may not have used email as well as the ZPR Portal while in Lithuania; his testimony on this point was confusing. Tr. 1517-20.

It is clear, however, that one of the reasons he preferred to use the ZPR Portal was to stymie Commission scrutiny of its contents, as Bauchle testified. Tr. 153. Max Zavanelli denied this, but the record contains numerous examples supporting this conclusion. Tr. 1716. On March 20, 2011, Max Zavanelli sent an email through the ZPR Portal stating that ZPR International should maintain its records completely separate from ZPRIM's and that related communications should be maintained on the ZPR Portal so that they could keep them away from the "prying eyes of the SEC Monster." Tr. 767-68; Div. Ex. 101. In the fall of 2011, Mark Zavanelli established ZPRIM's current email system, using the address syntax "zprim.net," and Max Zavanelli responded to this by warning Mark Zavanelli that ZPRIM emails were "available to the SEC . . . and they did ask for all zprim emails." Div. Ex. 105. Similarly, on November 17, 2011, he responded to a message from Fay regarding ZPRIM disclosures on its Form ADV, by removing the discussion to the ZPR Portal, stating "use only the portal [for] such discussions." Div. Ex. 106.

Max Zavanelli testified that he also used the ZPR Portals to discuss trading strategy and relay trading instructions. Tr. 803, 823, 826; Div. Ex. 98. For instance, a January 4, 2012, ZPR Portal email among Sappir, Bauchle, Max Zavanelli, and a representative from Grace Financial,

ZPRIM's former clearing broker, discussed a dispute over fees charged by Grace Financial for failed trades. Tr. 1171-72; Div. Ex. 122.

Bauchle testified that he sent daily trade, client, and valuation reports to Max Zavanelli over the ZPR Portal, and Max Zavanelli provided instructions to Bauchle over the ZPR Portal. Tr. 149-50. He said that the majority of ZPRIM's operations were conducted over the ZPR Portal, and that the ZPRIM email system was used mainly for client communications. Tr. 151. ZPR International staff typically updated ZPRIM's website, and often, ZPRIM staff would send data, including performance return numbers, over the ZPR Portal to either Max Zavanelli or the individuals in charge of uploading the data at ZPR International. Tr. 350. According to Bauchle, Max Zavanelli sent some trading instructions on clients' behalf over one of the ZPR Portals. Tr. 163. Marketing was also discussed over the ZPR Portals, as were GIPS compliance and ZPRIM's performance return rates. Tr. 168-69.

Sappir testified that he has used the ZPR Portal since 2007, which is inconsistent with testimony from Max Zavanelli that he first added Sappir to the Second ZPR Portal in 2011, and that he had not provided Sappir with access to the First ZPR Portal. Tr. 1170-71, 1716. Sappir communicated with others at ZPRIM over the ZPR Portal at least a few times a week, including for the purpose of receiving updates from Bauchle, Max and Mark Zavanelli, and Fay, who were all in different locations from Sappir. Tr. 1159-60. Max Zavanelli used the ZPR Portal to discuss potential marketing and trade recommendations with Sappir. Div. Ex. 149. Sappir did not ordinarily communicate with clients over the ZPR Portals. Tr. 1187.

Max Zavanelli testified that it was his policy not to allow client communications or marketing communications over the ZPR Portal. Tr. 1716. ZPRIM did not, however, maintain any written rules or make any mention of these policies in the firm's compliance manual. Tr. 411-12, 1717, 1819-20, 1837. Max Zavanelli testified, incredibly, that the ZPR Portal was not mentioned in the compliance manual because it "wasn't part of ZPR Investment Management." Tr. 1717. He said that where he saw infractions of his rule on client or marketing communications over the ZPR Portal, he would chastise the employee. Tr. 1717. He conceded, however, that nobody was policing or monitoring the ZPR Portal to ensure that employees followed his rules. Tr. 1718.

Max Zavanelli testified that ZPRIM did not maintain any records for ZPR International. Tr. 764. He first testified that he did not believe that ZPRIM had maintained information regarding any ZPR International client accounts, though it may have maintained information on ZPR International capital accounts. Tr. 765-66. A March 20, 2011, ZPR Portal message, however, asked Bauchle to delete historical data related to certain ZPR International accounts from ZPRIM's records because "there is always the stupid possibility that the SEC will decide to seize all of our US computers." Tr. 768; Div. Ex. 101. He then admitted that this indicated there were some documents related to ZPR International accounts at ZPRIM, and that he had them deleted, but that they were not the official records, which were maintained at ZPR International in Lithuania. Tr. 776-79. Max Zavanelli also told Sappir to delete messages that he received from ZPRIM clients over the ZPR Portal. Div. Ex. 126.

Max Zavanelli testified that he told ZPRIM staff, including Bauchle and Sappir, that there should be no client communications over the ZPR Portal. Tr. 771, 785; Div. Exs. 103, 126. On June 19, 2012, he sent a message to Sappir to this effect, and told him to delete certain client communications that were sent over the ZPR Portal and not to allow ZPRIM clients to use ZPR Portal addresses, because the emails were not subject to access by the Commission. Div. Ex. 103. Fay sent a ZPR Portal message on October 14, 2011, to ZPRIM staff informing them that the ZPR Portal should only be used for internal communications, and not to allow third parties or clients to use the portal addresses. Div. Ex. 111. There were at least a few instances of subsequent client communications over the ZPR Portal, however. See, e.g., Div. Exs. 112, 122, 125. Both Max Zavanelli and Fay acknowledged that some employees did not follow the rules regarding usage of the ZPR Portal, and that it was possible that clients communicated over it. Tr. 816, 1295. Fay testified that in her annual compliance reviews, she did not run any sort of forensic exam to determine whether any clients had used the ZPR Portal. Tr. 1292.

Fay testified that she and others at ZPRIM used the ZPR Portal like a drop box to transmit large files to Max Zavanelli, rather than sending the files by email. Tr. 1235. It was also used to communicate internally on issues that may have included GIPS. Tr. 1237; see also Div. Ex. 129. She represented that the ZPR Portal was not used to store ZPRIM books and records. Tr. 1233; Resp. Ex. 43 at 9; see also infra.

Fay testified that she was familiar with the books and records requirements under the Advisers Act and that ZPRIM did maintain everything required. Tr. 1283-84. She said that when books and records were transmitted over email or the ZPR Portal, the message was not usually saved, but the attached files would be saved independently. Tr. 1285. Max Zavanelli testified that all books and records sent over the ZPR Portal were saved twice, once in the ZPRIM computer system and once in the ZPR Portal, for messages sent after implementation of the Second ZPR Portal. Tr. 897.

#### 4. Disclosures to Commission Staff

During the Commission's 2009 examination of ZPRIM, the examination team made multiple requests of ZPRIM for documents, prior to the onsite visit, during the onsite visit, and following the onsite visit. The examination staff sent their initial request on January 14, 2009, to which was attached a Commission Form 1661, which outlines requirements of Commission-regulated firms during inspections and in their responses and productions to Commission staff. Tr. 447-48, 453; Resp. Ex. 42. The letter also attached a Form 1662, advising recipients of the consequences of failing to provide truthful statements or comply with Commission subpoenas and requests. Resp. Ex. 42 at 19. Most of the language from the Form 1661 comes from the Advisers Act, according to Cabot. Tr. 527-28.

After arriving onsite, the examination staff made a follow-up request on February 4, 2009, for all communications for Bauchle, Fay, and Max Zavanelli between July 1, 2008, and December 31, 2008. Tr. 338, 529; Resp. Ex. 42. Bauchle testified that he did not gather documents from the ZPR Portal for production because those communications were considered confidential, meaning that they were not available to the outside public, including the Commission. Tr. 151-53. He added that Max Zavanelli specifically told him not to produce the

ZPR Portal communications to Commission staff. Tr. 152, 165. ZPR International, not ZPRIM, owned the ZPR Portal, according to Bauchle, which is another reason the ZPR Portal's contents were not produced. Tr. 167. However, all of ZPRIM's communications files were produced, said Bauchle. Tr. 166-67. No log of ZPR Portal communications was provided to Commission staff. Tr. 172-73. Fay testified that she was involved with the gathering of records for the response to the Commission's requests. Tr. 1239. She conceded that the response to the Commission's request for communications between herself, Bauchle, and Max Zavanelli only included emails from ZPRIM's email system. Tr. 1239-40. Fay explained to Mark Zavanelli on September 9, 2011, that the firm's position had been that, as long as there was no client correspondence on the ZPR Portal, it was not subject to Commission review. Div. Ex. 130.

In March 2009, ZPRIM sent a response to the Commission examination staff's February 4, 2009, request for documents. Resp. Ex. 43. In it, ZPRIM stated that "ZPR owned a password protected Internet Portal" that was hosted, maintained, and backed up by a third party vendor. Tr. 1247; Resp. Ex. 43 at 9. The response claimed that "[t]he portal is not used for any of the categories covered by Rule 204-2." Id. The explanation also stated that the portal did not have a typical inbox function, but users could check a box to have the message sent to their inbox. Id. The response noted that the portal was not located in the United States. Id.

Cabot admitted that the examination staff received the letter around February 4, 2009, but that the staff did not notice the response regarding the ZPR Portal. Tr. 492-93, 501. Cabot also admitted that the examination staff asked no questions about the ZPR Portal and did not request any documents from it. Tr. 341-42, 503. She testified that ZPRIM failed to provide any information on the firm's Internet and email service providers regarding the ZPR Portal in response to the request in the examination team's January 14, 2009, letter. Tr. 460. Cabot also testified that ZPRIM did not produce any emails from the ZPR Portal in response to the examination team's requests. Tr. 453. Bauchle, Fay, and Sappir conceded that they did not. Tr. 173, 1182, 1239-40.

The first time that Bauchle discussed either version of the ZPR Portal with the staff was during his testimony preparation on the day before he was supposed to testify in the originally scheduled hearing. Tr. 147. He did not discuss the ZPR Portal during his investigative testimony in 2010, and he did not believe that any other ZPRIM employees or related parties disclosed it during the investigation. Tr. 336.

During Max Zavanelli's investigative testimony in June 2011, he was first asked if he had withheld any requested documents, and he said he had not. Div. Ex. 89 at 8-9. He was then asked what his email address was, and he first responded that it was max@zprintl.net. Div. Ex. 89 at 9-10. He then "corrected" himself and gave max@zprim.net as his email address, which, as he conceded during the hearing, he never used. Tr. 1647, 1656-57; Div. Ex. 89 at 9-10. He admitted that his first response during his investigative testimony was the ZPR Portal address. Tr. 1647, 1656. He testified during the hearing that he provided the incorrect email address

during his investigative testimony because it was shortly after ZPR International had created the Second ZPR Portal, and the ZPR Portal email addresses had just changed. Tr. 1649, 1657.<sup>31</sup>

### III. DISCUSSION AND CONCLUSIONS OF LAW

#### A. Adverse Inference

The Division requests that an adverse inference be drawn against ZPRIM and Max Zavanelli, based upon their alleged withholding and spoliation of evidence during the Commission's examination and investigation. Div. Br. 52-70. The Division claims that despite rules requiring preservation of books and records and specific requests from the Commission, ZPRIM withheld documents, and after years of failure to produce or preserve those documents, irretrievably lost them. *Id.* The Division requests an adverse inference that, had the Respondents produced the communications from the First ZPR Portal, they would have been adverse to their defense in this case. Div. Br. 70.

There are three elements required to establish an adverse inference for spoliation of evidence: the requesting party must show that (1) the party having control over the evidence had an obligation to preserve it when it was destroyed or altered; (2) the destruction or loss was accompanied by a 'culpable state of mind'; and (3) the evidence that was destroyed or altered was 'relevant' to the claims or defenses of the party that sought the discovery of the spoliated evidence, to the extent that a reasonable factfinder could conclude that the lost evidence would have supported the claims or defense of the party that sought it. Mazloun v. D.C. Metro. Police Dep't, 530 F. Supp. 2d 282, 291 (D.D.C. 2008) (quoting Thompson v. HUD, 219 F.R.D. 93, 101 (D. Md. 2003)). Spoliation is not a substantive claim but an evidentiary issue, and is thus "administered at the discretion of the trial court." Hodge v. Wal-Mart Stores, Inc., 360 F.3d 446, 450 (4th Cir. 2004) (quoting Vodusek v. Bayliner Marine Corp., 71 F.3d 148, 155 (4th Cir. 1995)).

The Division's points are well taken. Respondents communicated through the ZPR Portal at least in part because they believed doing so would prevent discovery of those communications by the Commission. They deliberately withheld records in the First ZPR Portal after being requested to provide them, and intentionally misdirected examiners and investigators by, for example, disclosing an unused email address. They flouted the Commission's authority in a manner that likely would not have been discovered but for the filing of the present proceeding. All these factors are relevant to the present proceeding, even though they constitute uncharged conduct, and I have considered the ZPR Portal evidence in evaluating both liability and sanctions.

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<sup>31</sup> I do not credit this testimony, inasmuch as it suggests a simple mistake. The Second ZPR Portal had been operational at the time of Max Zavanelli's investigative testimony for over three months, he provided investigators with a "correct address" that in fact he never used, and, most importantly, the other record evidence establishes overwhelmingly that he used the ZPR Portal for the purpose of evading Commission scrutiny. Tr. 149-50, 1657; Div. Ex. 89 at 8-10; Div. Ex. 157.

However, purely as an exercise of discretion, I decline to draw an adverse inference. As detailed infra, even without an adverse inference, the evidence is more than sufficient to show that ZPRIM made the charged material misrepresentations with scienter, and to support the Division's requested sanctions. As I noted during the hearing, the Division felt confident enough to pursue this proceeding even without any knowledge of the ZPR Portal. Tr. 21-22. The evidence shows that its confidence was well-placed, and there is no need for an adverse inference.

### **B. Max Zavanelli's Demeanor**

Similarly, the written record and testimony are generally sufficient to resolve whatever credibility issues have arisen, and I generally have not relied on Max Zavanelli's demeanor in resolving them. However, I would be remiss in failing to discuss it, because it was so extraordinarily poor.

Max Zavanelli was repeatedly disrespectful to Division counsel. When asked about an email "that [he] sent through the portal, an exchange between [Max Zavanelli] and Mark Zavanelli and some other people," he responded, "It's not from me. It's a follow-on e-mail. So get it right." Tr. 755, 757. In fact, the exhibit was an email string which included an email from Max Zavanelli and which was, overall, an exchange between him, Mark Zavanelli, and others. Div. Ex. 98. After admitting that he had directed employees to delete account records from ZPRIM's computers, he was asked, "Now, that's not the only time that you directed people at ZPR to destroy evidence, is it," to which he replied, "What kind of question is that?" Tr. 778, 780. In response to a series of questions regarding how attachments to ZPR Portal messages are automatically removed when a reply is sent, he stated, condescendingly, "You have to understand how e-mails work." Tr. 896.

His investigative testimony, which I admitted for substantive purposes, is replete with instances of combativeness, evasion, and non-responsive answers. Tr. 855; see generally Div. Ex. 89. Indeed, during the first half of his testimony, virtually every exhibit page of the transcript contains at least one example. The very first question was "Please state and spell your full name for the record," to which Max Zavanelli replied, "Okay. I'm the only child of two American hero[es] and I'm a former artillery officer with top secret crypto clearance and that's the highest in the land." Div. Ex. 89 at 4. He was then asked, "Before we get into that, why don't you state your name for the record," to which he replied "I will do that in time. In time I will do that." Id. His counsel then instructed him, "Max, we need to be responsive to her questions," and then cautioned him even more thoroughly after his very next remark, which was discursive and largely irrelevant. Id. at 4-5. Later, regarding the GIPS advertising guidelines, he was asked, "When was the first time you read it?" Div. Ex. 89 at 46. This colloquy took place:

A. Back in 2006. Now let me say –

MR. SNYDERBURN: Just listen to her question.

MR. ZAVANELLI: I just want to get to the heart of this. We are going to waste so much time.

MR. SNYDERBURN: You are going to have an opportunity.

MR. ZAVANELLI: I hope so, because this is pretty ridiculous.

Div. Ex. 89 at 46.

He was less defiant at the hearing, two years later, but he was still uncooperative, evasive, and discursive. Within moments of beginning his testimony, he talked over someone else (in this instance, Division counsel) for the first time. Tr. 740. He started evading questions at about the same time, and continued doing so throughout his testimony. Tr. 740; see generally Tr. 740-899, 1209-26, 1350-1738. He went off on a tangent for the first time shortly thereafter. Tr. 747.

Within the first hour of his testimony, I felt it necessary to caution Max Zavanelli regarding his conduct; he talked over me as I explained the problem:

Q. Would you please –

A. I know, but if I can't explain –

JUDGE ELLIOT: Mr. Zavanelli, Mr. Zavanelli, you understand –

THE WITNESS: I understand.

JUDGE ELLIOT: – your attitude, your demeanor –

THE WITNESS: I'm sorry.

JUDGE ELLIOT: – the things you say, you are fighting with Ms. Berlin, I'm going to take all those things into account when I write my initial decision.

THE WITNESS: I'm sorry. Okay.

Tr. 727, 768-69. I then ordered a short break to give Respondent a chance to confer with counsel. Tr. 769. It was just a few minutes later when, as noted supra, he responded to a question with, "What kind of question is that?" Tr. 780.

The next day, after a particularly dilatory and evasive series of answers to relatively simple questions, I ordered Max and Mark Zavanelli out of the courtroom and discussed the situation with counsel. Tr. 851-55. The parties agreed to admit Max Zavanelli's investigative testimony as a substantive exhibit, to avoid duplication of questioning and expedite the proceeding. Tr. 855. Just minutes later, after recommencing his testimony, I granted a motion to strike one of his answers as non-responsive, and Respondents' counsel cautioned him, "Please try to be responsive to Ms. Berlin's questions, and do not offer any additional information unless Ms. Berlin asks you questions or asks for additional information." Tr. 861-62.

Eventually, after a question on cross-examination which he answered especially evasively, I warned Max Zavanelli that I was considering striking all of his testimony:

JUDGE ELLIOT: All right. I will grant that motion [to strike]. So let me say this. I'm really, really getting tired of this, Mr. Zavanelli. You are not helping yourself. I told you this last time we were here. You are not helping yourself by being so resistant to answering questions, okay? I will - not now but I will, if you do this a few more times, I will sanction you and that sanction may be striking all of your testimony today. In other words, you will not be able to present your side of the story unless you answer questions under cross-examination. Do you understand? You may consider this your first warning. I will give you another warning when I think that you are not answering questions properly. And after that, I will entertain a motion from Ms. Berlin to strike all of your testimony today. Mr. Snyderburn will be able to be heard on that issue but I'm telling you now, I am seriously considering it so this is your first warning.

Tr. 1500-01.

Although I did not strike all of his testimony, on what was planned to be, and was, the last day of the hearing, when Max Zavanelli continued to misbehave under the Division's cross-examination, I proposed that the hearing end that day even if Max Zavanelli was not finished with his testimony: "if Mr. Zavanelli insists on answering questions in this discursive manner, then that's his problem, and he's not going to get his case put in." Tr. 1622. In opposing this proposal, which I ultimately ordered, Respondents' counsel observed that my threat to strike all of Max Zavanelli's testimony was "very stressful for him." Tr. 1624, 1628-29. The following colloquy ensued:

JUDGE ELLIOT: And, Mr. Zavanelli, I don't want to strike your testimony. I don't want to do that, okay? The point of my warning you was to get you to just answer the questions in a straightforward way, okay?

THE WITNESS: I'm sorry. It's my nature to discuss, and I'll try to control it. Sorry.

Tr. 1631. Even after that, I still had to intervene or strike an evasive response on several occasions. Tr. 1651, 1653, 1655, 1684, 1703, 1732.

Max Zavanelli's demeanor, attitude, and overall presentation are entirely consistent with the finding that he, and therefore ZPRIM, acted willfully and with scienter. See In re Columbia Securities Litig., 155 F.R.D. 466, 479 (S.D.N.Y. 1994) (evaluating scienter "generally requires examination of a witness's demeanor and credibility"); SEC v. Elliot, No. 09-cv-7594, 2012 WL 2161647, at \*2 (S.D.N.Y. June 12, 2012) (demeanor bolstered finding of scienter). I have specifically considered his demeanor in evaluating sanctions. See SEC v. Cavanagh, 1 F. Supp. 2d 337, 373 (S.D.N.Y. 1998) (demeanor relevant to evaluating likelihood of committing future violations).

### **C. Sections 206(1), 206(2), and 206(4) of the Advisers Act.**

ZPRIM violated Sections 206(1), 206(2), and 206(4)<sup>32</sup> of the Advisers Act.<sup>33</sup> Section 206 provides:

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—(1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client . . . (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

15 U.S.C. § 80b-6. To establish violations under sections 206(1), (2), and (4) of the Advisers Act, the Division must prove that ZPRIM was an investment adviser, that it engaged in fraudulent activities by jurisdictional means, and that it breached its fiduciary duty by making false or misleading statements or omissions of material fact at least negligently. SEC v. Gotchey, 981 F.2d 1251 (4th Cir. 1992); SEC v. Merrill Scott & Assoc., Ltd., 505 F. Supp. 2d 1193 (D. Utah 2007); see SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92 (1963). To establish a violation of Section 206(1), the Division must also prove that ZPRIM and Max Zavanelli acted with scienter. SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). As with Section 206(2), which prohibits engaging in “any transaction, practice, or course of business which operates as a fraud or deceit,” scienter need not be proven under Section 206(4). 15 U.S.C. § 80b-6(2), (4); Capital Gains Research Bureau, 375 U.S. at 195. To the extent Respondents’ misrepresentations violated Sections 206(1) and 206(2), they also violated Section 206(4). See SEC v. Blavin, 557 F. Supp. 1304, 1315 (D. Mich. 1983) (Section 206(4)’s standard is looser than that of 206(1), and so liability under 206(1) also creates liability under 206(4)). Accordingly, by virtue of their violations of Sections 206(1) and 206(2) (see infra), Respondents also violated Section 206(4).

#### **1. Registered Investment Advisers and Interstate Commerce**

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<sup>32</sup> Violation of one of its associated Rules is not a precondition to finding a violation of Section 206(4) of the Advisers Act. See Warwick Capital Mgmt., Inc., Advisers Act Release No. 2694 (Jan. 16, 2008), 92 SEC Docket 1410, 1411 n.3 (finding a violation of Section 206(4) without an associated violation of Rule 206(4)-1(a)(5)). ZPRIM is also accused of violating Advisers Act Rule 206(4)-1(a)(5), promulgated under Advisers Act Section 206(4), in connection with the Section 206(4) charge. The Rule 206(4)-1(a)(5) violation is evaluated separately, infra.

<sup>33</sup> ZPRIM was the “maker” of the fraudulent statements under Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011), because it “created” the materials and had ultimate legal control and responsibility for them. See Tr. at 457. Max Zavanelli’s statements and actions as the sole shareholder at the time are imputed to ZPRIM. SEC v. Blinder, Robinson & Co., Inc., 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972))

ZPRIM first registered as an investment adviser sometime soon after its formation in 1994, and after a period of deregistration, re-registered in April 2006. See OIP at 2; Answer at 2; ZPRIM 2013 ADV. It has been registered continuously since then. ZPRIM 2013 ADV.

ZPRIM and Max Zavanelli engaged in interstate commerce. ZPRIM's clients were located throughout the United States, the advertisements at issue in this matter were placed in nationally published magazines, and ZPRIM, and at its direction, its solicitor ZPR Client Services, sent its newsletters and Morningstar Reports by email to recipients scattered countrywide and globally. Div. Exs. 3-11, 21, 153-54.

## 2. Misrepresentations

ZPRIM made misrepresentations and omissions in its advertisements, its investment report newsletters, and its Morningstar reports.

Each of ZPRIM's magazine advertisements named in the OIP, and its April 2009 Newsletter, state "ZPR Management, Inc. claims compliance with the Global Investment Performance Standards (GIPS®)," which is the exact language that the GIPS advertising guidelines require for claiming GIPS compliance in advertisements. Div. Ex. 21 at 5-7; Div. Ex. 25 at 42; 26 at 35. The December 2009 Newsletter does not include the same standardized language, but in the section reporting performance returns, it states, "All numbers are GIPS compliant." Div. Ex. 9 at 3. By claiming GIPS compliance in advertisements and newsletters, ZPRIM obligated itself to comply with all of the GIPS advertising guidelines in these advertisements and newsletters—which qualify as advertisements under GIPS. Div. Ex. 25 at 41; Div. Ex. 26 at 35. None of these advertisements or newsletters, however, comply with the GIPS advertising guidelines.

The October, November, and December 2008 SmartMoney advertisements each claimed GIPS compliance, but failed to include either five years of annual returns or annualized one, three, and five-year returns. Div. Ex. 21 at 5-7. The October and November 2008 SmartMoney advertisements included only ten-year compounded and annualized returns, and the December 2008 SmartMoney advertisement included only five, ten, and twenty years of compounded, but not annualized, returns. Id. All three advertisements failed to provide period-to-date returns.<sup>34</sup> Id.

The February, March, and May 2011 magazine advertisements also made claims of GIPS compliance, using the GIPS advertising guidelines language. Div. Exs. 65-67. Each of these advertisements also failed to comply with the GIPS advertising guidelines. The February 2011 SmartMoney advertisement failed to provide three-year annualized returns for ZPRIM's Global Equity Composite and three and five-year returns for the ZPRIM's All Asian Composite. Div. Ex. 65. The March 2011 Barron's advertisement failed to provide three-year annualized returns

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<sup>34</sup> These advertisements also failed to include the currency used to express the returns and a description of how an interested investor could obtain a GIPS-Compliant Presentation, though the OIP did not make allegations regarding these missing items. Div. Ex. 21 at 5-7.

for ZPRIM's Global Equity Composite and three and five-year returns for the ZPRIM's All Asian Composite. Div. Ex. 67. The May 2011 SmartMoney advertisement also failed to provide three-year annualized returns for ZPRIM's Global Equity Composite and three and five-year returns for the ZPRIM's Asian Composite. Div. Ex. 66. All three advertisements failed to include period-to-date returns. Div. Exs. 65-67.

Respondents argue that the February, March, and May 2011 advertisements were not misleading because they were simply reprinting material that had already been published in Pensions & Investments magazine, and which could not be altered. Resp. Br. 26-28. The OIP, however, charges that ZPRIM inaccurately claimed GIPS compliance in these three advertisements. The OIP does not allege that the performance returns were misleading, and if the material could not be presented without violating GIPS, then ZPRIM should not have claimed GIPS compliance. Similarly, Max Zavanelli maintained that he could not comply with the GIPS advertising guidelines, even if he could alter the tables, because he did not have comparative information for the other firms listed in the tables created by Pensions & Investments. Tr. 1670. Again, the issue is claiming GIPS compliance without actually complying, and if the material could not be presented without violating GIPS, then ZPRIM should not have claimed GIPS compliance.

The investment report newsletters, which are advertisements under GIPS, also made claims of GIPS compliance.<sup>35</sup> Div. Ex. 8-9; Div. Ex. 25 at 42; Div. Ex. 26 at 35. The April 2009 Newsletter included the same GIPS compliance claim that ZPRIM used in its magazine advertisements; this claim came verbatim from the GIPS advertising guidelines. Div. Ex. 8 at 3. The April 2009 Newsletter included returns for ZPRIM's composites for the prior month as well as for certain shorter periods. Div. Ex. 8 at 1-3. The April 2009 Newsletter included neither year-by-year annual, nor annualized one, three, and five-year returns, nor period-to-date returns. Id. The December 2009 Newsletter included one-month, and shorter, period returns for each of ZPRIM's composites, and included some tables that were previously published in Pensions & Investments, showing gross one and five-year returns for its International Equity Composite and gross and net five-year returns for its SCV Composite. Div. Ex. 9. In addition to missing the required returns for all composites for which it provided returns, the tables reprinted from Pensions & Investments omitted comparisons to the composites' benchmarks, as required under GIPS. Div. Ex. 9; Div. Ex. 25 at 42.

Respondents argue that, with respect to the magazine advertisements and investment report newsletters, they never misrepresented the actual performance of the various composites, and that all of the numbers they produced were correct and accurate. Resp. Br. 43. This argument misconstrues the Division's claims against them: that Respondents falsely claimed

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<sup>35</sup> It is clear that the investment report newsletters are advertisements under the definition in the GIPS advertising guidelines, which include materials that attempt to solicit new clients or maintain existing clients. Div. Ex. 25 at 41; Div. Ex. 26 at 35. Even if the materials were not aimed at soliciting new clients, they were unquestionably used to maintain Respondents' existing clients. Indeed, although Max Zavanelli testified that he did not initially believe the newsletters constituted advertising, when asked if he understood that they "could be deemed" advertising, he responded, "I do now." Tr. 1439.

GIPS compliance in advertisements without providing GIPS-compliant advertisements. OIP at 3, 5. The OIP did not allege that any of the returns were inaccurate. Moreover, the fact that every word or number in an advertisement is itself accurate and true does not preclude a finding of misrepresentation where the advertisement is “deceptive and misleading in [its] overall effect.” SEC v. C.R. Richmond & Co., 565 F.2d 1101, 1106-07 (9th Cir. 1977). ZPRIM’s claim of GIPS compliance, without following the GIPS guidelines, made the advertisements and newsletters misleading.

ZPRIM knew that clients and prospective clients would have understood that the GIPS-related statements in ZPRIM’s advertisements were claims that the advertisements themselves were GIPS compliant. The language that ZPRIM used to claim such GIPS compliance was the Standardized Claim. See Div. Ex. 25 at 42; Div. Ex. 26 at 35. The Standardized Claim differs from the analogous language suggested for GIPS-Compliant Presentations. See Div. Ex. 25 at 16; Div. Ex. 26 at 18. ZPRIM knew when to use which language, as shown by its use of the appropriate statement in its GIPS-Compliance Presentations, which state, “[ZPRIM] has prepared and presented this report in compliance with [GIPS].” Div. Ex. 19 at 3.

Moreover, a firm cannot be GIPS compliance on an ad hoc basis, but must maintain compliance at all times. Tr. 922, 938. ZPRIM’s repeated failure to follow GIPS advertising guidelines calls into question whether ZPRIM was in a position to claim GIPS compliance as a firm.<sup>36</sup>

ZPRIM’s September 30, 2010, and March 31, 2011, Morningstar reports<sup>37</sup> both falsely reported that there was no Commission investigation pending, when in fact there was a pending investigation by August 2010. Div. Exs. 10, 11. ZPRIM’s September 30, 2010, Morningstar report also incorrectly stated that the firm’s performance returns had been verified by Ashland “through the present.” Div. Exs. 10, 11. Ashland had resigned as the firm’s verifier on July 9, 2010, and had made clear that its verification extended only through December 31, 2009. Div. Ex. 36. Further, ZPRIM had not yet hired Alpha at the time of the September 30, 2010, Morningstar report. Tr. 398. Thus, not only was the statement that Ashland had verified the returns “through the present” untrue, but also the representation that verification after December 31, 2009, had occurred at all was untrue.

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<sup>36</sup> ZPRIM cannot point simply to verification reports to substantiate compliance. Verifiers can only base their decision to verify on what the firm discloses to them. If a firm, like ZPRIM, withholds non-compliant advertisements from the verifier, there is no opportunity to judge the firm’s full universe of compliance. As Feliz testified, had Ashland been made aware of the non-compliant advertisements earlier, it may have decided to resign earlier than it did. Tr. 973.

<sup>37</sup> Though Morningstar produced the reports, the data used for the reports was submitted by ZPRIM, and Morningstar and its readers could reasonably rely on ZPRIM’s representations.

Finally, the Commission is not required to prove reliance in an enforcement action and, therefore, whether customers actually relied on ZPRIM's GIPS compliance is not a defense.<sup>38</sup> See e.g., SEC v. Simpson Capital Mgmt., Inc., 586 F. Supp. 2d 196, 201 (S.D.N.Y. 2008) (“Unlike private litigants, the SEC is not required to prove investor reliance . . . in an action for securities fraud.”); SEC v. Rana Research, Inc., 8 F.3d 1358, 1363 & n.4 (9th Cir. 1993); SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985).

### 3. Scienter

ZPRIM, through Max Zavanelli, acted with scienter. Scienter is defined as a “mental state embracing the intent to deceive, manipulate, or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980). A finding of recklessness satisfies the scienter requirement. David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-9 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991) (citing eleven circuits holding that recklessness satisfies scienter in Section 10(b) and Rule 10b-5 actions). Recklessness, in the context of securities fraud, is “highly unreasonable” conduct, “which represents ‘an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.’” Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1977) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)); see also S.W. Hatfield, CPA, Securities Exchange Act of 1934 (Exchange Act) Release No. 69930 (Jul. 3, 2013), 2013 WL 3339647 at \*21.

“Negligence is the failure to exercise reasonable care or competence.” Byron G. Borgardt, 56 S.E.C. 999, 1021 (2003). The standard of care for a registered investment adviser is based on its fiduciary duty. See Transamerica Mortg. Adviser, Inc. v. Lewis, 444 U.S. 11, 17 (1979); Capital Gains Research Bureau, 375 U.S. at 191-92. Investment advisers have an “affirmative duty of ‘utmost good faith, and full and fair disclosure of all material facts.’” Capital Gains Research Bureau, 375 U.S. at 194 (citations omitted); Blavin, 760 F.2d at 711-12. Respondents were required to “employ reasonable care to avoid misleading” clients. See Capital Gains Research Bureau, 375 U.S. at 194; SEC v. Moran, 922 F. Supp. 867, 895-96 (S.D.N.Y. 1996). Ultimately, the standard is one of “reasonable prudence, whether it usually is complied with or not.” Vernazza v. SEC, 327 F.3d 851, 861 (9th Cir. 2003) (citation omitted). As applicable here, an investment adviser has a “professional duty” to inform investors of risks. Blavin, 760 F.2d at 712; see SEC v. Fife, 311 F.3d 1, 10 (1st Cir. 2002).

#### i. Magazine Advertisements and Investment Report Newsletters

The evidence clearly establishes that ZPRIM was either intentionally deceptive in its magazine advertisements and newsletters, or departed from the standard of care to an extreme degree by being oblivious to the obvious danger of deception presented by them. Max Zavanelli testified that he was ultimately responsible for the creation and placement of all advertisements and investment report newsletters and their GIPS compliance claims until October 2011, when

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<sup>38</sup> It is undisputed that Respondents received no new clients as a result of the violative advertisements. Tr. 889, 1728.

his son took over as president and chief compliance officer. Tr. 837, 1483-86; Div. Ex. 89 at 29, 42-46, 59, 81. He also authorized the six magazine advertisements and two investment report newsletters at issue in this case, and he authorized the placement of GIPS compliance claims in those particular advertisements and newsletters. Tr. 1409, 1443-44, 1503-04, 1668; Div. Ex. 89 at 55, 62.

ZPRIM included claims of GIPS compliance in the magazine advertisements and investment report newsletters because it believed it would help attract institutional investors. Bauchle testified that ZPRIM learned from Greg Reed that claiming GIPS was a prerequisite to attracting institutional clients, and that is why ZPRIM began making the claim. Tr. 184-85. Max Zavanelli testified that he was, at the very least, aware that claiming GIPS would help ZPRIM attract institutional investors. Tr. 1391-92.<sup>39</sup>

The format for the October, November, and December 2008 SmartMoney advertisements was modified from the format ZPRIM had used in at least four advertisements earlier in 2008, including two that ran in SmartMoney, which included year-by-year annual returns for the SCV Composite. Div. Ex. 21 at 1-4. The October 2008 advertisement was the first instance, at least in 2008, of ZPRIM excluding year-by-year returns or period-to-date returns. Compare Div. Ex. 21 at 1-4 with Div. Ex. 21 at 5. As established during the hearing, had ZPRIM followed its previous advertisement format, it would have shown that ZPRIM had negative returns and was underperforming its Russell 2000 Index benchmark. Tr. 379, 478, 1497. According to Bauchle, avoiding disclosure of the negative returns and negative benchmark comparison was the principal reason for changing the format of the advertisements so that they would show only favorable comparisons, which Max Zavanelli insisted was compliant with GIPS because potential investors would receive ZPRIM's GIPS-Compliant Presentation. Tr. 188-89, 225-26. Cabot testified that in 2009, Bauchle told a similar story to her during the examination, providing support for Bauchle's version. Tr. 488.

Max Zavanelli contends that even though he approved use of GIPS compliance in the October, November, and December 2008 advertisements, those advertisements were substantively edited without his input, and that he only learned of the advertisements' lack of GIPS compliance after they had already run. Additionally, he represented that he did not receive sufficient warning from Bauchle or Ashland about those advertisements' lack of compliance in time to do anything about it. As noted supra, I do not credit these portrayals. Instead, I credit Bauchle's testimony, and conclude that Max Zavanelli knew that the fall 2008 SmartMoney advertisements were not GIPS compliant, and intended to run them anyway to avoid revealing negative returns and negative benchmark comparisons.

Max Zavanelli's version of events appears unlikely in any event. It would be uncharacteristic of Max Zavanelli to grant carte blanche authority to Bauchle and Sappir to reformat the advertisement for three consecutive advertisements without checking the advertisements. He was and continues to be intimately involved in nearly every aspect of what

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<sup>39</sup> I do not credit Max Zavanelli's portrayal of ZPRIM's GIPS compliance as motivated by a desire for "bragging rights." His insistence on including claims of GIPS compliance in advertisements makes it clear that it was about more than self-congratulation.

ZPRIM discloses to the public. Bauchle testified that Max Zavanelli controlled the material in the advertisements, and made all final decisions regarding any claims of GIPS compliance in them; he was the “boss man.” Tr. 145, 186-87, 429. Max Zavanelli conceded his involvement and final authority on all advertisements. Tr. 837; Div. Ex. 89 at 29, 46. He was also protective of ZPRIM’s brand, and reluctant to release information that might cast ZPRIM in an unfavorable light, making it more believable that he directed the reformatting of the advertisements in the fall of 2008. For example, he ordered a portion of the GIPS-Compliance Presentation disclosing ZPRIM’s assets under management taken off of the firm’s website, because he was concerned that institutional investors would consider the numbers unbecoming of a serious money manager. Tr. 209, 957-60; Div. Ex. 89 at 145. Similarly, he became upset with Bauchle after Bauchle had distributed a copy of the full GIPS-Compliant Presentation, with the assets under management figures, to all recipients of the firm’s investment report newsletters, because he did not want those GIPS-Compliant Presentations broadly distributed. Tr. 206-07.

Max Zavanelli’s claim that he did not receive timely warning on the lack of GIPS compliance is also unsupported. Bauchle said that he told Max Zavanelli that the format Max Zavanelli insisted upon for the “September through December” 2008 advertisements was not GIPS compliant, prior to ZPRIM running the fall 2008 advertisements, and specifically that the advertisements were not GIPS compliant because they lacked one, three, and five-year returns, and that they lacked period-to-date returns.<sup>40</sup> Tr. 225-26, 401-03. Bauchle testified that Max Zavanelli told him that one, three, and five-year returns, in addition to period-to-date returns, were unnecessary because potential investors would eventually receive a GIPS-Compliant Presentation with that information. Tr. 225-26, 402. Although Fay did not recall any such

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<sup>40</sup> Respondents’ criticism of Bauchle’s testimony on this point is unpersuasive. See Resp. Br. 22-23. Bauchle testified during the investigation that “if it’s not one, three and five year annualized it’s not [GIPS] compliant.” Div. Ex. 155 at 103. This was under questioning about the January 2008 SmartMoney advertisement, which only showed yearly returns. Id.; Div. Ex. 21 at 1. Bauchle opined that this advertisement was not GIPS compliant, and in fact it was not, although not for the reason Bauchle cited. Div. Ex. 27 at 2-3; Div. Ex. 155 at 103-04; Tr. 938-39. Bauchle then testified that he told Max Zavanelli that the advertisement was not GIPS compliant, but did not suggest to Max Zavanelli that anyone else should review the advertisement for GIPS compliance. Div. Ex. 155 at 104-05. Bauchle also opined during the hearing that the January 2008 advertisement was not GIPS compliant, but only because it used the term “audited.” Tr. 402. He further testified that showing annual returns had been ZPRIM’s “standard format up to that point,” and that he had furnished the (essentially identical) January 2008 Kiplinger advertisement to Ashland. Tr. 402, 419. Bauchle did not explain why his opinion of the January 2008 advertisements changed between 2010 and 2013, but the most reasonable explanation is that he simply became more familiar with the GIPS advertising guidelines. Moreover, that Bauchle provided the January 2008 Kiplinger advertisement to Ashland on his own initiative is not inconsistent with his investigative testimony that he did not suggest doing so to Max Zavanelli. Div. Ex. 155 at 105; Resp. Br. 22-23. Finally, that Bauchle referred to the fall 2008 advertisements as the “September through December” 2008 advertisements in no way suggests that there actually was a September 2008 advertisement. Tr. 401; Resp. Br. 22-23. Overall, I find Bauchle’s testimony on this point credible.

conversation, Bauchle testified that he raised the same issue with her. Tr. 204-05, 1265-67. In any event, Bauchle credibly testified that he had to go along with whatever Max Zavanelli decided. Tr. 205. Bauchle's version of events is bolstered by the fact that it parallels the dispute Max Zavanelli had with Ashland regarding the investment report newsletters. As to those, Max Zavanelli was reluctant to include all of the GIPS-required returns because, he reasoned, potential investors would receive ZPRIM's GIPS-Compliant Presentations. Tr. 226, 402-04.

Max Zavanelli disputed that Bauchle informed him the advertisements were not GIPS compliant prior to running the advertisements, but his version of events is, once again, inconsistent. He testified during the investigation that after the December 2008 advertisement had run, Bauchle told him that the December 2008 advertisement was not GIPS compliant. Div. Ex. 89 at 59. Max Zavanelli said that after Bauchle told him this, he "immediately realized that the other two were not [GIPS] compliant either." Id. At the hearing, however, Max Zavanelli stated that the first time he saw any of the October, November, or December 2008 advertisements was during the 2009 Commission examination, when Cabot showed them to him. Tr. 1415-16. He added that the purpose of Cabot showing the advertisements was limited at that point to figuring out why the two advertisements had conflicting returns for the same dates. Tr. 1417. He said that Cabot never mentioned that those advertisements were not GIPS compliant, and that he only learned of the Commission's concerns with ZPRIM's advertisements, specifically that there were GIPS issues, when he received the Deficiency Letter in 2010. Tr. 1433, 1446.<sup>41</sup>

As for the 2011 advertisements, Max Zavanelli admitted that he authorized the addition of the claim of GIPS compliance in the advertisements, even though the Pensions & Investments tables could not be altered to comply with the requirements in the GIPS advertising guidelines. Tr. 1504-05, 1662-64. He, and therefore ZPRIM, were unquestionably aware of the GIPS advertising guidelines' requirements for one, three, and five-year returns after having received warnings from Ashland and the Commission. Indeed, by the time of the 2011 advertisements, ZPRIM had represented in a letter to Commission staff that it would take measures to correct these problems in its advertisements. Div. Exs. 77, 78. By that point, Max Zavanelli had heard from Bauchle that the October, November, and December 2008 advertisements lacked required one, three, and five-year returns, and were thus not GIPS compliant. Div. Ex. 89 at 59.

Max Zavanelli created or directed the investment report newsletters' content, and he was responsible for including the claims of GIPS compliance in those investment report newsletters as well.<sup>42</sup> Tr. 1443. Max Zavanelli's chief argument against a finding of scienter in placing the

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<sup>41</sup> Additionally, Fay spoke to Max Zavanelli shortly after the completion of the Commission's examination in 2009, to inform him of the examination team's initial findings. Tr. 1254. It seems unlikely that Fay, his chief compliance officer, would have failed to mention significant issues the Commission discovered during the examination, especially when the firm purportedly placed a temporary moratorium on advertising after the exit interview. Tr. 1270-71.

<sup>42</sup> Though the December 2009 Newsletter did not use the phrasing required by the GIPS advertising guidelines, claiming that the comparative performance return numbers were GIPS compliant had the same purposeful effect.

GIPS compliance claims in the investment report newsletters is that he did not believe, and still does not believe, that the investment report newsletters constitute advertisements under the definition provided in GIPS, because, he argues, they were not used for marketing purposes. Tr. 1439. Although he was not generally a believable witness, there is little to discredit his testimony on this point, and I find that he genuinely believed this. Notwithstanding his sincerity, his belief constituted a reckless disregard for the GIPS advertising guidelines, which he testified he was familiar with, and of advice from both Commission staff and Ashland informing him that the investment report newsletters were advertisements.<sup>43</sup>

Max Zavanelli familiarized himself with the GIPS guidelines in 2006 when ZPRIM first began claiming GIPS compliance, and he maintained that familiarity going forward. Tr. 1571, 1674; Div. Ex. 89 at 42-43. The 2005 GIPS Guidelines he reviewed include the GIPS advertising guidelines that make abundantly clear that “any written material . . . distributed to maintain existing clients or solicit new clients” is an advertisement. Div. Ex. 25 at 41. Commission staff conveyed similar advice, during its examination, as did Ashland, during its verifications, and Mark Zavanelli, in a series of emails in 2012. Tr. 199-200, 431-32, 476, 991, 1449; Div. Exs. 47, 77, 138. It is true that some of the investment report newsletters’ content focused upon various market and financial issues and not necessarily ZPRIM products. See, e.g., Tr. 1439; Div. Exs. 8, 9. But the investment report newsletters also included discussions of ZPRIM’s positive performance returns as well as explanations not only of why poor performance returns occurred, but how the firm intended to overcome them. Tr. 1442, Div. Ex. 8 at 1-4; Div. Ex. 9 at 1-3. As Max Zavanelli said, the investment report newsletters conveyed “why we’re losing money, why we’re making money.” Tr. 1442. Similarly, the December 2009 investment report newsletter reprinted tables from Pensions & Investments magazine and boasted of ZPRIM composites as top producers. Div. Ex. 9 at 3. These were undoubtedly efforts by ZPRIM to both attract new investors and to maintain existing clients.

Additionally, Ashland informed ZPRIM through Bauchle numerous times that the investment report newsletters were considered advertisements, but Max Zavanelli simply refused to follow Ashland’s advice. Div. Ex. 47. At one point, Ashland had told Bauchle that if it intended not to include return information required by the GIPS advertising guidelines, he would have to send a GIPS-Compliant Presentation to recipients of the investment report newsletter, advice Bauchle heeded in late 2009. Tr. 206-07. Max Zavanelli disagreed with Bauchle’s decision to include the GIPS-Compliant Presentation and ordered him not to do so again. Tr. 207-08. Max Zavanelli wrote about this concern in the December 2009 Newsletter. Div. Ex. 9 at 4. Thus, Max Zavanelli was aware by the December 2009 investment report newsletter that Ashland had an issue with the investment report newsletters’ claims of GIPS compliance, but Max Zavanelli recklessly chose to ignore Ashland’s advice, despite claiming to rely on them as ZPRIM’s GIPS “expert.” Tr. 1571-72; Div. Ex. 89 at 59.

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<sup>43</sup> Max Zavanelli testified that, had he received the letter from Ashland after his telephone call with them in early 2010, he would have chosen the option Ashland provided to remove all claims of GIPS from the investment newsletters. Tr. 1458. It is unlikely he would have heeded that advice, however, because Ashland had already provided those options to him during the telephone calls in late 2009 and early 2010, and he still refused to accept that they were his only two choices. Tr. 1449-52.

Max Zavanelli's claims during the hearing and during his investigative testimony that he did not realize the advertisements had to comply with their own independent guidelines are unpersuasive. See, e.g., Tr. 1661-62; Div. Ex. 89 at 70 (claiming that he was "starting to understand" that representing that the firm was GIPS compliant in its advertisements required the firm to comply with the GIPS advertising guidelines). Max Zavanelli was well versed in GIPS and its requirements, and he knew the rewards and consequences of making a claim of GIPS compliance, casting serious doubt on these representations. Tr. 1674. He testified that he first familiarized himself with GIPS in 2006, when ZPRIM first began claiming GIPS compliance, and he indicated at various times that he was familiar with the standards of AIMR, GIPS' predecessor. Tr. 1674; Div. Ex. 89 at 43-44. He also testified during his investigative testimony that he was the "closest thing to an expert" in the room, that is, that he believed himself better qualified on GIPS than the Commission's staff. Div. Ex. 89 at 59.<sup>44</sup>

ii. Morningstar Reports

ZPRIM acted only negligently with respect to the September 30, 2010, Morningstar report's claim of having been audited, and the March 31, 2011, Morningstar report's misrepresentation regarding the Commission investigation. See SEC v. Steadman, 967 F.2d 636, 643 n.5, 647 (D.C. Cir. 1992) (a finding of simple negligence is sufficient to find violation of Advisers Act Sections 206(2) ). Bauchle was the only one involved with updating the Morningstar database during the relevant period. Tr. 269-71. There was no evidence that Max Zavanelli directed Bauchle on how to answer the questions in the Morningstar database. Bauchle was aware that Ashland had terminated its relationship with ZPRIM by July 2010, well before he updated Morningstar with the information for the September 30, 2010, report. Tr. 208-09. Bauchle testified that he did not intentionally indicate that Ashland continued to verify ZPRIM's GIPS compliance through the periods represented in the Morningstar reports. Tr. 277; Resp. Ex. 27. Instead, he inserted the phrase "through the present" as a way of self-updating, in case he forgot to change the date in that section during his quarterly updates. Tr. 272, 277; Resp. Ex. 27. Bauchle explained to Max Zavanelli shortly after the OIP that he had inadvertently neglected to update the section disclosing Ashland as ZPRIM's verifier, though he recognized that he should have. Resp. Ex. 27. There is evidence that Bauchle knew as of October 14, 2010, presumably after the publication of the September 30, 2009, Morningstar report, that ZPRIM was under investigation by the Commission. Tr. 437-38. However, the preponderance of the evidence does not establish either that Bauchle knew that before October 14, 2010, or that he knew it in time to correct the September 30, 2009, Morningstar report. Bauchle's mistake was plainly not reasonably prudent—he should have made a point of understanding exactly what it means to have a "pending SEC investigation," so as to act with the utmost good faith expected of an investment adviser—but neither was it an extreme departure from the standard of care, or committed with an intent to defraud.

In contrast, ZPRIM acted with scienter with respect to the March 31, 2011, Morningstar report's misrepresentation regarding the Commission investigation. Bauchle admitted that he

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<sup>44</sup> He also testified that ZPRIM hired Ashland to be its expert on GIPS. Tr. 1571; Div. Ex. 89 at 59. But he refused to listen to Ashland's advice when it contradicted his views.

knew in October 2010 that a Commission investigation was pending. He initially testified, however, that ZPRIM staff would meet “whenever we would get a new letter from the SEC” and downplay the significance of the investigation; in essence, ZPRIM staff engaged in wishful thinking. Tr. 285-86. This was encouraged by Max Zavanelli, who admitted that he would have checked the “no” box under “Pending SEC investigations” if he had been responsible for doing so. I am not convinced that Bauchle’s failure to properly update Morningstar in time for the March 31, 2011, report constituted an intentional effort to mislead, because I credit his explanation that it was the result of willful blindness to the facts. However, it was clearly reckless. I therefore find that ZPRIM, through Bauchle, the one ZPRIM staff member responsible for the Morningstar database, violated sections 206(1), 206(2), and 206(4) with respect to the March 31, 2011, Morningstar report’s misrepresentation regarding the Commission investigation, and sections 206(2) and 206(4) with respect to the September 30, 2010, Morningstar report’s claim of having been audited.

#### 4. Materiality

The Division proved that ZPRIM’s misrepresentations about GIPS compliance in its advertisements were material. The standard of materiality under Section 206 is whether a reasonable investor would have considered the information important in deciding whether to invest. See Basic, Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality is proved by showing a “substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” SEC v. Ginsburg, 362 F.3d 1292, 1302 (11th Cir. 2004) (quoting TSC Indus., 426 U.S. at 449 (1976)). Materiality does not require proof that accurate disclosure would have caused the reasonable investor to change his decision, but only that the omitted fact would have assumed actual significance in the deliberations of the reasonable investor. TSC Indus., 426 U.S. at 449.

As a general matter, “misrepresentations overstating [Respondents’] performance as against market benchmarks [is] material.” Seaboard Investment Advisers, Inc., 54 S.E.C. 1111, 1118 (2001). More specifically, GIPS compliance is a threshold factor for institutional investors considering money managers, as both Bauchle and Max Zavanelli acknowledged. Tr. 185-86, 827-28. Feliz testified, similarly, that institutional investors will not consider money managers that are not GIPS compliant. Tr. 904-05. The court in Riggs Investment Management Corp. v. Columbia Partners, LLC, 966 F. Supp. 1250, 1262 (D.D.C. 1997), which presented a similar situation, explained that “compliance with AIMR [GIPS’ predecessor] has importance for a firm’s reputation.” It stands to reason that firms like ZPRIM include claims of GIPS compliance in their advertisements because, to institutional investors, GIPS compliance is important in deciding whether to invest. Claims of GIPS compliance are voluntary, but investors know that firms that choose to make such claims must undertake additional, mandatory disclosure obligations. Tr. 926; Div. Ex. 25; Div. Ex. 26 at 35. As the court held in Riggs, “Violation of AIMR does not, in and of itself, mean that the [law] is violated. But to advertise oneself as meeting such an important industry standard while knowingly being out of compliance is false advertising.” Id. at 1268.

The manner in which ZPRIM failed to comply with GIPS supports this conclusion. ZPRIM failed to disclose underperformance of one of the SCV Composite's indexes, in addition to its negative returns, in its October, November, and December 2008 advertisements. By providing only five, ten, and twenty-year returns, ZPRIM could report strong returns—double and even triple the returns of the SCV Composite's benchmarks. Div. Ex. 21 at 5-7. Instead, as outlined supra, one-year returns and period-to-date returns for the SCV Composite would have shown returns that were not only negative, but also underperforming one of the SCV Composite's benchmarks, the Russell 2000 index. Tr. 1502; Div. Ex. 18. Investors would want to know that the returns reported created a false impression of the firm's recent performance "because investors routinely consider an adviser's past investment performance and attractiveness to other investors when making investment decisions." Warwick Capital Mgmt., Inc., 92 SEC Docket at 1423. Max Zavanelli conceded that knowledge that a firm's composites did not meet its benchmarks is important to investors. Tr. 1552.

Riggs provides insight into why these claims of GIPS compliance in advertisements that failed to comply with GIPS were material. The defendants in Riggs falsely claimed compliance with AIMR in advertisements in which they linked performance returns with those from an adviser's prior partners, hoping to convince investors that the firm's track record was more substantial than it was. 966 F. Supp. at 1262. The court in Riggs remarked, "a three-to-five year performance record is a prerequisite to an investment manager receiving his recommendation to a client. That such advertising is material in effect cannot be doubted." Id. at 1269. So, too, was ZPRIM's failure to report its composite's underperformance while claiming GIPS compliance.

Feliz testified that claims of GIPS compliance provide comfort to investors, when comparing money managers, "that the presentations they're looking at are fairly presented," and that claims of GIPS compliance create expectations of uniformity and comparability, in addition to integrity of return presentations. See Tr. 903-904; Div. Ex. 25 at 9, 41; Div. Ex. 26 at 7. Max Zavanelli demonstrated how compliance with GIPS advertising guidelines, or lack thereof, materially affected ZPRIM's portrayal in advertisements, and thus comparability, in an article he authored for ZPRIM's December 2009 investment report.<sup>45</sup> Div. Ex. 9 at 4. In the article, he remarked that asset weighting portfolios, which is required for GIPS reporting, does not reflect ZPRIM's success. Id. He also expressed, referring to the GIPS-Compliant Presentation that Bauchle had distributed against Max Zavanelli's wishes, that "the disclosure tables sent out for us do not reflect our true situation." Id. Prohibiting firms from reporting performance in incomparable terms to reflect the firm in the best light possible, as determined by the firm, is exactly the goal that GIPS reporting strives for, and investors expect that a firm claiming GIPS compliance in an advertisement will abide by GIPS' terms.

The misrepresentations in the Morningstar reports were also material because they provided a false impression about ZPRIM's verification. Just as GIPS compliance is considered an important factor for institutional clients, so is GIPS verification. As Feliz testified, GIPS

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<sup>45</sup> Sappir underscored the importance of GIPS by frequently promoting the firm's GIPS compliance in his marketing. In several emails sent by Sappir to potential clients, Sappir made note of the firm's GIPS compliance and the fact that it was verified. See Tr. 1151, 1153; Div. Exs. 60-62.

verification is essentially an industry requirement. Tr. 904. Indicating that ZPRIM was verified through “the present,” meaning September 30, 2010, when it had last been verified as of December 31, 2009, and omitting the fact that the verifier had since resigned, would plainly have been material to investors. Similarly, interested investors would want to know whether an investment adviser was under Commission investigation. See In re Gentiva Sec. Litig., 932 F. Supp. 2d 352, 387 (E.D.N.Y. 2013) (listing cases where stock price drops were triggered by announcements of Commission investigations and inquiries).

Respondents argue that clients’ after-the-fact receipt of materials, including ZPRIM’s GIPS Compliant Presentations, and the availability of its GIPS Compliant Presentations on its website, mitigated or eliminated any misleading characteristic of the advertisements and newsletters. Resp. Br. 2, 43. This misses the point. The issue is whether the advertisements were materially misleading, not whether anyone was actually misled. Even assuming that follow-up materials would have cleared up any confusion, the advertisements themselves were still materially misleading.

#### **D. Advisers Act Rule 206(4)-1(a)(5)**

ZPRIM violated Advisers Act Rule 206(4)-1(a)(5) by providing material misrepresentations in its advertisements. Rule 206(4)-1(a)(5) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) for a registered investment adviser to publish, circulate, or distribute any advertisement “[w]hich contains any untrue statement of a material fact, or which is otherwise false or misleading.” 17 C.F.R. § 275.206(4)-1(a)(5). Conduct under this Rule must be measured from the viewpoint of a person unskilled and unsophisticated in investment matters. See SEC v. C.R. Richmond & Co., 565 F.2d 1101, 1104-05 (9th Cir. 1977). Scierer is not an element. See Capital Gains Research Bureau, 375 U.S. at 195.

The term “advertisement” in Rule 206(4)-1(a)(5) includes “written communication[s] addressed to more than one person, or any notice or other announcement in any publication or by radio or television.” 17 C.F.R. § 275.206(4)-1(b). The concept of advertisement has been construed liberally, and includes “[i]nvestment advisory material which promotes advisory services for the purpose of inducing potential clients to subscribe to those services.” C.R. Richmond, 565 F.2d at 1105.

The magazine advertisements unquestionably constitute advertisements within the meaning set forth above. SmartMoney and Barron’s are magazines. Div. Exs. 66, 67. Morningstar compiles the data submitted by money managers and packages it into reports that assign between one and five stars, pursuant to Morningstar’s trademarked star rating system, and they are then sold to institutional investors researching money managers. Tr. 249, 1798-99. ZPRIM submitted its performance data to Morningstar for inclusion in its reports, and ZPRIM included Morningstar’s star rating for its composites in its advertisements throughout the relevant period, and at least as far back as January 2008. See Div. Ex. 21 at 1. ZPRIM distributed its Morningstar reports to potential clients as well. Tr. 1631-33, 1646; Div. Exs. 152-154.

ZPRIM's argument that Morningstar reports are not advertisements because they are not available to non-subscribers is flawed. There is no requirement that advertisements be widely publicized, or be publicized beyond a specific group. Indeed, multiple courts have found violations of Advisers Act Rule 206(4)-1(a)(5) for misrepresentations by investment advisers in subscription newsletters. SEC v. Fin. News Assoc., No. 84-civ-878, 1985 WL 25023, at \*2, \*10 (E.D. Va. Apr. 26, 1985); SEC v. Blavin, 557 F. Supp. 1304, 1308, 1315 (E.D. Mich. 1983); SEC v. Suter, No. 81-civ-3865, 1983 WL 1287, at \*14 (N.D. Ill. Feb. 11, 1983).

#### **E. Max Zavanelli's Liability**

The OIP charges that both ZPRIM and Max Zavanelli are primarily liable, and that Max Zavanelli is alternatively liable as an aider and abettor and cause of ZPRIM's violations. OIP at 6. As noted, ZPRIM is liable as to all alleged violations, except for violations of section 206(1) of the Advisers Act with respect to the Morningstar reports. To establish a claim of aiding and abetting there must be: (1) a primary violation of the securities laws; (2) knowledge of the primary violation by the aider and abettor; and (3) substantial assistance by the aider and abettor in the commission of the primary violation. SEC v. DiBella, 587 F.3d 553, 566 (2d Cir. 2009). The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant. See Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990). Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. See KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 (2001), recon. denied, Exchange Act Release No. 44050 (Mar. 8, 2001), 74 SEC Docket 1351, pet. denied, 289 F.3d 109 (D.C. Cir. 2002).

Max Zavanelli acted with scienter as to those violations which involved scienter, and provided much more than substantial assistance. He was not only the controlling sole shareholder of ZPRIM, he was the creator of the magazine advertisements and the investment report newsletters, and he admitted enrolling ZPRIM in the Pensions and Investments/Morningstar service. The finding that ZPRIM violated Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-1(a)(5) thereunder, inescapably leads to a finding that Max Zavanelli aided and abetted and caused those violations. See Sharon M. Graham, 53 S.E.C. 1072, 1085 n.35 (1998) (finding of aiding and abetting necessarily implies that respondent caused the primary violations), aff'd, 222 F.3d 994, 1000 (D.C. Cir. 2000).

An associated person may be charged as a primary violator, where, as here, the associated person controlled the investment adviser. See John J. Kenny, 56 S.E.C. 448, 485 n.54 (2003); Alexander V. Stein, 52 S.E.C. 296, 299 & n.10 (1995) ("Our authority . . . does not rest on whether or not an entity or individual has registered . . . [but] on whether or not an entity or individual in fact acted as an investment advisor."). Accordingly, Max Zavanelli is primarily liable for the charged violations with respect to the magazine advertisements and newsletters. However, because he was not directly involved in ZPRIM's relationship with Morningstar, the preponderance of the evidence does not establish primary liability with respect to the Morningstar violations. Thus, I find that he only caused those.

## **F. Affirmative Defenses**

Respondents raised six affirmative defenses in their Answer: (i) full and fair disclosure, (ii) lack of materiality, (iii) lack of scienter, (iv) good faith, (v) lack of causation, and (vi) statute of limitations. They did not discuss any of them in their briefs, and they are in any event meritless. Defenses (i)-(v) are not actionable affirmative defenses; rather, they are arguments aimed at refuting the core bases for the Commission's alleged violations. All of these issues are addressed in the legal discussion, supra. Respondents offered no facts or arguments as to how this proceeding or any potential sanctions would run afoul of the five-year statute of limitations set forth by 28 U.S.C. §2462. This case was instituted on April 9, 2013, and the earliest violation alleged in the OIP was the October 2008 SmartMoney advertisement, which was published fewer than five years before the OIP. I have taken into account pre-April 9, 2008, conduct for various purposes, but I have not found any violations based on such conduct. See Terry T. Steen, 53 S.E.C. 618, 623-25 (1998) (conduct outside the limitations period may be used to establish motive, intent, and knowledge). Accordingly, I deny all of Respondents' affirmative defenses.

## **V. SANCTIONS**

The Division requests, as to ZPRIM, a cease-and-desist order, civil penalties, and censure, and as to Max Zavanelli, a cease-and-desist order, civil penalties, and permanent direct and collateral bars. Div. Br. at 70-78. As to the civil penalties, the Division urges a single second-tier penalty of \$375,000 against ZPRIM and eleven second-tier penalties (i.e., one per alleged violation) totaling \$795,000 against Max Zavanelli. Div. Br. at 77.

### **A. Willfulness and the Public Interest**

Some of the requested sanctions are only appropriate if Respondents' violations were willful. See 15 U.S.C. § 80b-3(e)(5), (f). A finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976). Respondents' actions were plainly willful: Max Zavanelli designed ZPRIM's advertisements, wrote ZPRIM's newsletters, and personally made the decisions to not follow GIPS. As to the Morningstar reports, Bauchle affirmatively determined how to enter the false information.

When considering whether an administrative sanction serves the public interest, the Commission considers the factors identified in Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981): the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations (Steadman factors). See Altman v. SEC, 666 F.3d 1322, 1329 (D.C. Cir. 2011); Gary M. Kornman, Advisers Act Release No. 2840 (Feb. 13, 2009), 95 SEC Docket 14246, 14255, pet. denied, 592 F.3d 173 (D.C. Cir. 2010). Other factors the Commission has considered include the age of the violation (Marshall E. Melton, 56 S.E.C. 695, 698 (2003)), the degree of harm to investors and the marketplace resulting from the violation (id.), the extent to which the sanction will have a deterrent effect (see Schield Mgmt.

Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46), whether there is a reasonable likelihood of violations in the future (KPMG, 54 S.E.C. at 1185), and the combination of sanctions against the respondent (id. at 1192). See also WHX Corp. v. SEC, 362 F.3d 854, 859-61 (D.C. Cir. 2004). The Commission weighs these factors in light of the entire record, and no one factor is dispositive. KPMG, 54 S.E.C. at 1192; see Gary M. Kornman, 95 SEC Docket at 14255.

Respondents' eleven violations between October 2008 and March 2011 were obviously recurrent. Respondents' degree of scienter for each violation varied. As to the magazine advertisements, the scienter was relatively high, because Zavanelli intended to conceal his poor performance from investors. As to the newsletters and the March 31, 2011, Morningstar report, the scienter was relatively low, because Zavanelli sincerely, but recklessly, believed that the newsletters were not advertisements, and because Bauchle was willfully blind to the fact of the Commission's investigation. As to the September 30, 2010, Morningstar report, there was no scienter because the violation involved only negligence.

As to egregiousness, a comparison to Seaboard is instructive. In Seaboard, the respondents had been the subject of a 1994 cease-and-desist order relating to, among other things, advertising erroneously high performance figures. 54 S.E.C. at 1112-13. Thereafter, Seaboard issued individual client letters, which erroneously reported either high performance figures or low benchmark figures. Id. at 1113-14. After Seaboard settled a district court action involving post-1994 misconduct, a follow-on proceeding was instituted pursuant to Sections 203(e) and 203(f) of the Advisers Act. Id. at 1112. On appeal from the administrative law judge's initial decision, the Commission held that Seaboard's conduct was egregious, because "Respondents overstated the performance of client portfolios by making inaccurate and false comparisons to market indices," in an attempt to avoid losing customers as a result of the 1994 proceeding. Id. at 1117-18. Most of Respondents' misconduct was comparable to that of the respondents in Seaboard, because both the present Respondents and the Seaboard respondents overstated the performance of client portfolios by making inaccurate and false comparisons to market indices.<sup>46</sup> The Morningstar reports' false statements were similarly serious. On balance, I find that Respondents' misconduct was egregious.

As for the other Steadman factors, Respondents' occupations present opportunities for future violations. However, Respondents differ in the degree to which they have provided assurances against future violations and recognized the wrongful nature of their conduct. ZPRIM is now owned by, and operated at least in part by, Mark Zavanelli. Although his inability to recognize the existence of a Commission investigation is troubling, he otherwise credibly testified that ZPRIM is making, and has made, considerable progress in improving its compliance practices. Tr. 1764-68. Respondents' Answer, submitted jointly, is unusually forthright in admitting that, for example, the October, November, and December 2008 SmartMoney advertisements "did not comply with GIPS Advertising Guidelines." Answer at 3. Overall, I find that ZPRIM has provided sincere assurances against future violations and recognized the wrongful nature of its conduct.

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<sup>46</sup> Granted, the Seaboard respondents did so while under a previous cease-and-desist order, and Respondents did not, but the Seaboard respondents' advertising was directed at individual clients, while Respondents' was made available to the entire industry.

Max Zavanelli, however, has not provided sincere assurances or recognized the wrongfulness of his conduct. He repeatedly provided incredible testimony, concocted post-hoc rationalizations for his misdeeds, and evaded responding to the Division's questions. He repeatedly refused to accept direction from myself and from his own counsel, even with repeated reminders and sanction warnings. He endeavored—unfortunately, with some success—to evade the Commission's oversight by routing some ZPRIM communications through the ZPR Portal, and then gave false investigative testimony to keep the Division from inquiring further. The evidence is overwhelming that, like the respondents in Seaboard, Max Zavanelli “do[es] not understand the regulatory and fiduciary responsibilities of an investment adviser.” Seaboard, 54 S.E.C. at 1120.

### **B. Cease-and-Desist**

Advisers Act Section 203(k) authorizes the Commission to impose cease-and-desist orders for violations of the Advisers Act. See 15 U.S.C. §§ 80b-3(k). The Commission requires some likelihood of future violation before imposing such an order. KPMG, 54 S.E.C. at 1185. However, “a finding of [a past] violation raises a sufficient risk of future violation,” because “evidence showing that a respondent violated the law once probably also shows a risk of repetition that merits our ordering him to cease-and-desist.” Id. at 1185. In evaluating the propriety of a cease-and-desist order, the Commission considers the Steadman factors, as well as the recency of the violation, the resulting harm to investors in the marketplace, and the effect of other sanctions. Id. at 1192.

As for ZPRIM, the Steadman factors are mixed, the violations were as recent as 2011, no investors were harmed, and the other sanctions (i.e., a censure and one-time civil penalty) are relatively mild. The public interest factors are not in equipoise, however, because I place more weight on the unusually recurrent nature of the violations, the fact that ZPRIM's misconduct was sufficient to justify registration revocation rather than merely a censure, and the fact that Max Zavanelli remains intimately involved in ZPRIM's operations, all of which weigh in favor of a heavy sanction. E.g., Piper Capital Mgmt., Inc., 56 S.E.C. 1033, 1082, 1085 (2003) (revoking investment adviser's registration, among other sanctions, for “fraudulent and deceitful conduct”). Accordingly, a cease-and-desist order against ZPRIM is appropriate.

As for Max Zavanelli, the Steadman factors all weigh heavily in favor of a severe sanction, except for scienter, which varied, and the violations were recent. Although no investors were harmed and the other sanctions are severe, these two factors are insufficient to avoid imposition of a cease-and-desist order.

### **C. Censure and Associational Bar**

Section 203(e) of the Advisers Act authorizes the Commission to revoke an investment adviser's registration if: (1) it, or any person associated with it, has willfully violated, or willfully aided and abetted the violation of, any provision of the Advisers Act; and (2) revocation is in the public interest. 15 U.S.C. § 80b-3(e). As discussed above, the Steadman factors are mixed as to ZPRIM, demonstrating that a sanction less severe than revocation or suspension is appropriate. I find that censure is appropriate to vindicate the public interest.

Section 203(f) of the Advisers Act authorizes the Commission to bar or suspend a person from association with an investment adviser for willful violations of the Advisers Act, if it is in the public interest. 15 U.S.C. § 80b-3(f); see John W. Lawton, Advisers Act Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722, 61732 n.30, 61737 (collateral bars may be imposed based on conduct predating July 22, 2010). Again, all Steadman factors except scienter weigh heavily in favor of a permanent associational bar; scienter weighs in favor of it, also, but less heavily. Furthermore, it is in the Commission's interest to deter others from behaving like Max Zavanelli. In addition to intentionally misleading clients and prospective clients, he refused to accept responsibility for the abdication of his fiduciary duty to his clients. Therefore, it is in the public interest to permanently bar him from association with investment advisers, brokers, dealers, municipal securities dealers, municipal advisors, transfer agents, and nationally recognized statistical rating organizations.

#### **D. Civil Penalties**

Under Section 203(i) of the Advisers Act, the Commission may impose a civil money penalty if a respondent willfully violated any provision of the Advisers Act, and if such penalty is in the public interest. 15 U.S.C. §§ 80b-3(i) (2006). A three-tier system establishes the maximum civil money penalty that may be imposed for each violation found. Id. Where a respondent's misconduct involved fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, the Commission may impose a "Second-Tier" penalty of up to \$65,000 for each act or omission by an individual and \$325,000 for an entity, for violations occurring between February 15, 2005, and March 3, 2009, and \$75,000 and \$375,000, respectively, for violations occurring between March 4, 2009, and March 5, 2013. Id.; 17 C.F.R. §§ 201.1003, .1004 (adjusting the statutory amounts for inflation). Where an individual respondent's misconduct did not involve fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, the Commission may impose a "First-Tier" penalty of up to \$6,500 or \$7,500, respectively. 15 U.S.C. §§ 80b-3(i); 17 C.F.R. §§ 201.1003, .1004. Within any particular tier, the Commission has the discretion to set the amount of the penalty. See Brendan E. Murray, Advisers Act Release No. 2809 (Nov. 21, 2008), 94 SEC Docket 11961, 11978; The Rockies Fund, Inc., Exchange Act Release No. 54892 (Dec. 7, 2006), 89 SEC Docket 1517, 1528.

In determining whether a penalty is in the public interest, six factors may be considered: (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment and prior restitution, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. 15 U.S.C. § 80b-3(i); Brendan E. Murray, 94 SEC Docket at 11978.

I find that sanctioning both Respondents with second-tier penalties is warranted and in the public interest, as the Division has presented no evidence that ZPRIM and Max Zavanelli's violations actually harmed investors (or other persons) or caused them unjust enrichment. On the other hand, Respondents acted deceitfully and flouted the Commission's authority. Max Zavanelli has been sanctioned before, for similar misconduct. The need to deter Respondents is strong, given Max Zavanelli's continued employment in the securities industry, continued involvement with ZPRIM, and failure to acknowledge the wrongfulness of his conduct. See

Brendan E. Murray, 94 SEC Docket at 11978. Sanctions imposed on Respondents will also deter others from engaging in similar misconduct. Id.

Nonetheless, the Division's requested penalty is excessive. Although the tier determines the maximum penalty, "each case has its own particular facts and circumstances which determine the appropriate penalty to be imposed" within the tier. SEC v. Murray, No. OS-CV-4643 (MKB), 2013 WL 839840, at \*3 (E.D.N.Y. Mar. 6, 2013) (quotation omitted); see also SEC v. Kern, 425 F.3d 143, 153 (2d Cir. 2005). In assessing the public interest of imposing civil penalties, these factors—in addition to the statutorily defined factors cited above—may be considered:

(1) the egregiousness of the violations at issue, (2) defendants' scienter, (3) the repeated nature of the violations, (4) defendants' failure to admit to their wrongdoing; (5) whether defendants' conduct created substantial losses or the risk of substantial losses to other persons; (6) defendants' lack of cooperation and honesty with authorities, if any; and (7) whether the penalty that would otherwise be appropriate should be reduced due to [respondents'] demonstrated current and future financial condition.

SEC v. Lybrand, 281 F. Supp. 2d 726, 730 (S.D.N.Y. 2003), aff'd on other grounds, 425 F.3d 143 (2d Cir. 2005) (Lybrand factors).

Most of the Lybrand factors—namely, egregiousness, recurrence, lack of cooperation, and financial condition—weigh in favor of a severe sanction. Although the "dissemination of false and misleading financial information by its nature causes serious harm to investors and the marketplace," in this case there is no evidence of actual losses, and the evidence of a risk of substantial losses is at best equivocal. See The Rockies Fund, 89 SEC Docket at 1527. ZPRIM's remedial efforts reflect, and portions of the Answer and Mark Zavanelli's testimony constitute, admissions of wrongdoing; Max Zavanelli's testimony, by contrast, demonstrates a denial of wrongdoing. Also, the degree of scienter varied: the six magazine advertisements involved high scienter, the two newsletters and one Morningstar report involved a lesser degree of scienter, and two Morningstar reports involved no scienter at all. Accordingly, the requested civil penalties are too high.

As to ZPRIM, the Division requests that the maximum second-tier civil penalty of \$375,000 be imposed one time. Div. Br. at 77. While the statute provides that a penalty may be imposed for "each act or omission," it leaves the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979). Although ZPRIM violated the statute eleven times, a one-time penalty prejudices them the least. In view of the totality of the evidence, a one-time, second-tier \$250,000 penalty for ZPRIM, or two-thirds of the maximum, is appropriate.

As to Max Zavanelli, the Division requests the maximum second-tier penalty for each of his eleven violations. Because two of the Morningstar reports did not involve fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, only a first-tier penalty may be

imposed for those. However, the maximum penalty within each tier is appropriate. Thus, as to each alleged violation, the following amounts will be imposed, for a total penalty of \$660,000:

October 2008 <u>SmartMoney</u> advertisement	\$65,000
November 2008 <u>SmartMoney</u> advertisement	\$65,000
December 2008 <u>SmartMoney</u> advertisement	\$65,000
February 2011 <u>SmartMoney</u> advertisement	\$75,000
May 2011 <u>SmartMoney</u> advertisement	\$75,000
March 2011 <u>Barron's</u> advertisement	\$75,000
April 2009 newsletter	\$75,000
December 2009 newsletter	\$75,000
September 2010 Morningstar report (audited)	\$7,500
September 2010 Morningstar report (investigation)	\$7,500
March 2011 Morningstar report	\$75,000

## VI. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on May 5, 2014.

## VII. ORDER

IT IS ORDERED that, pursuant to Section 203(e) of the Advisers Act, ZPR Investment Management, Inc., is CENSURED.

IT IS FURTHER ORDERED that, pursuant to Section 203(f) of the Advisers Act, Max E. Zavanelli is permanently BARRED from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization.

IT IS FURTHER ORDERED that, pursuant to Section 203(k) of the Advisers Act, ZPR Investment Management, Inc., shall CEASE AND DESIST from committing, and Max E. Zavanelli shall CEASE AND DESIST from committing, aiding and abetting, or causing the commission of, any violations or future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.

IT IS FURTHER ORDERED that, pursuant to Section 203(i) of the Advisers Act, ZPR Investment Management, Inc., shall PAY A CIVIL MONEY PENALTY in the amount of \$250,000.

IT IS FURTHER ORDERED that, pursuant to Section 203(i) of the Advisers Act, Max E. Zavanelli shall PAY A CIVIL MONEY PENALTY in the amount of \$660,000.

Payment of penalties shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by certified check, United States postal money order,

bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying the Respondent(s) and Administrative Proceeding No. 3-15263, shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Bld., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Cameron Elliot  
Administrative Law Judge