

INITIAL DECISION RELEASE NO. 476  
ADMINISTRATIVE PROCEEDING  
FILE NO. 3-14697

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

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In the Matter of :  
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LISA B. PREMO : INITIAL DECISION  
 : December 26, 2012  
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APPEARANCES: Martin F. Healey and Daniel Barry for the Division of Enforcement,  
Securities and Exchange Commission

David Spears and Justin Deabler for Lisa B. Premo

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

On January 17, 2012, the Securities and Exchange Commission (Commission) issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 (Advisers Act), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (Investment Company Act) (OIP). At a public hearing on June 21-22, 25-26, 2012, the Division of Enforcement (Division) presented six witnesses, including one expert; Lisa Premo (Premo) testified as part of her direct case and was called by the Division. The final brief was filed on September 17, 2012.<sup>1</sup>

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 and proposed findings and conclusions that are inconsistent with this Initial Decision.

**Findings of Fact**

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<sup>1</sup> “(Tr. \_\_.)” refers to the transcript of the hearing. I will refer to Division and Respondent exhibits as “(Div. Ex. \_\_),” and “(Resp. Ex. \_\_),” respectively. The Division’s Post-Hearing Brief is referred to as “(Div. Br. \_\_.)” Respondent’s Post-Hearing Brief is referred to as “(Resp. Br. \_\_.)” The Division’s Post-Hearing Reply Brief is referred to as “(Div. Reply \_\_.)”

## **Evergreen Investment Management Company, LLC**

During 2007-2008, Evergreen Investment Management Company, LLC (Evergreen) was a registered investment adviser and subsidiary of Wachovia Corporation (Wachovia) that resulted from Wachovia's acquisition of banks that had asset management units.<sup>2</sup> Tr. 22-23, 842; Div. Ex. 3 at 12. Evergreen's primary location was in Charlotte, North Carolina, with offices at other locations, including Boston, Jacksonville, Los Angeles, New York, Philadelphia, and Richmond. Tr. 22-23, 586. In this time period, Evergreen had about \$300 billion in assets under management (AUM) in mutual funds and private accounts. Tr. 13-14, 22.

### **Lisa B. Premo**

Lisa B. Premo (Premo), B.S. in Economics, with honors, from the Wharton School at the University of Pennsylvania, and a M.B.A. in Finance, with honors, from New York University, has more than twenty years of experience in the securities industry, most of it with Evergreen and its predecessor companies. Tr. 841-42. In 2007 to mid-2008, Premo was a very successful investment manager with particular expertise in the domestic fixed-income mortgage market for Evergreen, working out of Charlotte, North Carolina. Tr. 841-49, 593. Premo managed mutual funds that received high Morningstar ratings, she was named an Evergreen "Hero," and Evergreen recommended her for inclusion in the Wall Street Journal's Top Fifty Women to Watch. Tr. 844.

As Director, Mortgage-Backed Securities and Structured Products (Structured Products), she led portfolio management teams for five mutual funds and five private clients and had eight people reporting to her in mid-2007. Tr. 82, 849. One of these funds was the Evergreen Ultra Short Opportunities Fund (Ultra Short Fund), a short-duration bond fund, with an average rating of AA, which Premo started and for which she was the lead portfolio manager. Bob Rowe (Rowe) was co-manager and Michael Sun (Sun) was a supporting research analyst.<sup>3</sup> Tr. 52, 79-80, 309, 316, 335, 641, 886, 914; Div. Ex. 1 at 12. The Ultra Short Fund "was a series of the Evergreen Fixed Income Trust, an open-end management investment company (i.e., a mutual fund) registered with the Commission." OIP at 2. Evergreen received advisory fees based on the net asset value (NAV) of each fund it advised. Div. Ex. 1 at 12.

In December 2007, Premo was promoted to Chief Investment Officer of Liquidity and Structured Solutions (CIO LASS), which meant forty-four people reported to her, and she was responsible for 515 private accounts and fifteen mutual funds. Tr. 65, 82, 659, 803, 847-51, 862,

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<sup>2</sup> Wells Fargo & Company has acquired Wachovia which had merged with First Union Corporation (First Union). Tr. 106, 430, 585. In 2007-2008, Evergreen was the registered adviser for the Evergreen family of mutual funds. Tr. 22.

<sup>3</sup> Rowe joined First Union in 1998 and remained with successor companies until 2008. Tr. 303-05. Premo promoted him to an analyst position and was his direct supervisor for nine and a half years. Tr. 304-06. Rowe became a portfolio manager in 2001, and also worked on other funds with Premo. Tr. 306, 311. Rowe earned around \$700,000 by 2007. Tr. 369.

868-89. Premo's testimony is that Rowe assumed her title as Director, Structured Products in December 2007 or January 2008.<sup>4</sup> Tr. 849; Resp. Ex. 900 at 1237.

Premo testified that after she became CIO LASS, she was not in the office much of the time because of meetings, she became less of a hands-on portfolio manager, she spent between 75 and 80 percent of her time on her new areas of responsibility, and she delegated most of the responsibilities she had as Director, Structured Products, to Rowe.<sup>5</sup> Tr. 81-82, 849, 852, 855, 980. Premo continued as the lead portfolio manager for the Ultra Short Fund from December 2007 through June of 2008, and the fund's Prospectus in effect for February through June 2008, showed Premo in this capacity. Tr. 976-77. Premo testified she retained the lead manager title because she was so closely identified with the Ultra Short Fund; Rowe continued as co-manager; and their collaborative working relationship continued. Tr. 852-53, 976-77. Premo and Rowe worked in adjacent cubicles, and Rowe's regular practice was to alert Premo as soon as he received information. Tr. 77, 81-83, 89, 94, 322-23. Premo had the final say on the management team's pricing decision for the Ultra Short Fund. Tr. 317.

In July 2007, Premo informed her supervisors that she did not have the resources to handle the increasing workload, "We're drowning over here." Tr. 858-59; Resp. Ex. 5. In March 2008, Premo assumed responsibility for a new fund in the approximate \$10 billion range. Tr. 917. In the first half of 2008, Premo and Rowe believed they were overburdened because Structured Products was short staffed and the workload had increased exponentially. Tr. 373-74, 860-61. Brian McCarthy (McCarthy), Pricing Administrator, Fund Administration Unit (Fund Administration), sent Premo an e-mail on May 30, 2008, following a conversation commenting that "you guys are getting stretched to the absolute limits," and Premo agreed wholeheartedly. Resp. Exs. 206, 928 at 3.

### **Evergreen's Fund Administration Unit and Valuation Committee**

In 2007-2008, Evergreen valued securities for NAV purposes in one of three ways: publicly-traded equities were valued at their current market price; securities that were not publicly traded, mainly fixed-income securities, were fair valued by third-party vendors or brokers, and, on exception, by the portfolio managers.<sup>6</sup> Tr. 19, 44, 110, 177-78, 190; Div. Ex. 2 at 2. It was Evergreen's policy to value the same securities at the same price in each fund. Tr. 618, 739.

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<sup>4</sup> The only document showing Rowe in the position is dated September 2008. Tr. 974-75; Resp. Ex. 900.

<sup>5</sup> Premo's new responsibilities included overseeing money market funds. Evergreen had over \$45 billion in money market funds, a part of the industry that had problems in 2007-2008. Tr. 855-57, 863-64.

<sup>6</sup> The outside sources included vendors Standard & Poor's (S&P), IDC, Reuters, and Bear Stearns. Div. Ex. 3 at Bates No. 1530. S&P stopped providing quotes on some securities sometime in 2007 or the first half of 2008. Tr. 212. Brokers included BB&T Capital, Lewis Securities or Lewis Trading (Lewis), and a branch of Wachovia Securities. Tr. 122-23, 134, 195.

The Evergreen Board of Trustees (Board or Trustees) delegated to the Valuation Committee (VC) responsibility for overseeing pricing to ensure compliance with its written Procedures for Daily Portfolio Pricing (Pricing Procedures).<sup>7</sup> Tr. 23, 432; Div. Ex. 2. “Ideally, the daily security prices are provided by a 3rd party pricing vendor.” Div. Ex. 3 at Bates No. 1530. The VC, consisting of a chair and several senior Evergreen managers, held monthly and special meetings by telephone because members were located in different locations and also used notation voting. Tr. 28-31, 65-66, 112-14, 433-34. Premo became a voting member of the VC when she became CIO LASS in December 2007. Tr. 65. Rowe was not on the VC, but he attended some of the meetings. Tr. 345.

The VC did not price securities; it was responsible for reviewing and approving the prices for fixed-income securities where there was no market price. Tr. 19, 23-26, 33, 44, 111-12. The VC approved: (1) the fair value prices presented by a fund’s portfolio management team; and (2) whether to use vendor or internal pricing to determine fair value. Tr. 19, 24, 44-46, 48, 111, 193. A portfolio management team had to obtain permission from the VC to switch from vendor pricing to broker pricing (broker overrides). Tr. 111, 179. The VC did not review market, vendor, or broker prices, which were considered independent. Tr. 44, 118.

Evergreen’s Fund Administration, headed by Kasey Phillips (Phillips),<sup>8</sup> provided administrative services to the funds.<sup>9</sup> Tr. 435. Pricing Administration was a team within Fund Administration that administered the VC and provided operational support for securities pricing. Tr. 441. Phillips was also Treasurer of Evergreen’s individual funds and as such she communicated the VC’s reports to each individual fund’s trustees. Tr. 431, 434.

McCarthy functioned as the secretary of the VC.<sup>10</sup> Tr. 54, 107-08; Div. Ex. 3. McCarthy never recommended a value to the VC, but relied on the portfolio managers, such as Premo or Rowe. Tr. 115-116, 124-25, 284. McCarthy saw his responsibility as gathering and presenting information. Tr. 254. Prior to the monthly VC meetings, McCarthy electronically provided the VC with reports on the fair value items to be considered, he prepared minutes of VC meetings, and he

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<sup>7</sup> The OIP states that “The EVC was established by the Ultra Fund’s Board of Trustees,” however the evidence is that it was created by Evergreen. See OIP at 2.

<sup>8</sup> Phillips earned an accounting degree from St. Michael’s College in Winooski, Vermont. Tr. 461. She began her career as an Arthur Andersen auditor in 1992. Tr. 429. In 1996, she joined Keystone Investments, which became Evergreen. Tr. 223, 430-32. Phillips was on the VC from when it was formed in 2000 and was chair from January through June 2008. Tr. 18, 432. Phillips has been the Treasurer and head of Fund Administration with Wells Fargo Advantage Funds since late 2009. Tr. 428-29, 431.

<sup>9</sup> Fund Administration also produced shareholder reports and oversaw State Street in the latter’s role as fund accountant and custodian. Tr. 435, 478-79.

<sup>10</sup> McCarthy is a graduate of the University of Notre Dame with a degree in Finance. Tr. 170.

circulated a Weekly Pricing Summary for the securities the VC was considering.<sup>11</sup> Tr. 27-28, 40, 54, 66-67, 114-15, 127-28; Div. Exs. 3, 4. The Weekly Pricing Summary contained information about each fair-valued security. Tr. 135-36. The Weekly Pricing Summary for June 16-20, 2008, was thirty-eight pages and mentioned seventeen fair-valued positions. Div. Ex. 4.

### **NovaStar Bond, Tranche A2**

Evergreen created the Ultra Short Fund in 2003. Tr. 308. Under Premo's management it grew to approximately \$700 or \$750 million in AUM in 2007. Tr. 852. In the first quarter of 2007, the Ultra Short Fund purchased \$13 million of Tranche A2 of NovaStar ABS CDO I, Ltd. (NovaStar or NSCDO) bonds, a collateralized debt obligation (CDO) where the structured cash flow originated with a basket of mortgages, primarily subprime residential mortgages, rated triple A.<sup>12</sup> Tr. 55, 61, 175-76, 312, 336-37. Rowe recommended the purchase to Premo. Tr. 313. Evergreen did not have a lot of subprime instruments; NovaStar was the exception and it was purchased knowing that the market was factoring in a lot of bad news. Tr. 919-20. At Premo's recommendation, four other Evergreen funds also bought pieces of NovaStar, Tranche A2. Tr. 166, 221, 690-91; Div. Ex. 4 at 9. Premo trusted Rowe and thought he did a good job. Tr. 95. She preferred that Rowe speak about NovaStar because he "always was the person who knew that bond the best, because he purchased it, he did the original analysis." Tr. 958, 980, 1015. Premo considered Rowe and Sun responsible for monitoring the NovaStar bond transaction. Tr. 914, 916.

On July 26, 2007, Premo wrote a detailed e-mail titled "Re: Invitation: Special Valuation Committee Meeting – Possible Price Overrides," to members of the VC and others. Resp. Ex. 804. In that e-mail, Premo described the purchase of the NovaStar bond, after problems with subprime instruments were known.

We did purchase a subprime abs CBO, NSCDO 2007-1A A2, the bond in question, earlier this year, after the news of the problems in subprime were well known. We felt that it was a cheap addition to several of our portfolios at the time, and since it carried a AAA rating, we were not as concerned with credit risk as we would have been on a lower rated bond. There are also structural nuances on the NSCDO bond (e.g., the pikable nature of the subordinates in the transaction, which have the effect of turboing the cash flows to the senior bonds upon 8.5% of the underlying transactions being downgraded by S&P, as well as "deep" mortgage insurance) that are not being considered in the matrix pricing exercises.

Resp. Ex. 804 at 2; Tr. 876-78.

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<sup>11</sup> At the time, McCarthy did not know that some participants were taping the meetings. Tr. 258. Premo believes the Weekly Pricing Summary and minutes did not contain relevant information and many came out in June for prior periods. Tr. 993-94. McCarthy acknowledged that he wrote some minutes for the period April through June in July 2008. Tr. 258, 993-94.

<sup>12</sup> The initial principal value of Tranche A1 and Tranche A2 was \$243.7 million and \$34.9 million, respectively. Tr. 424; Div. Ex. 11; Resp. Ex. 514.

1. At 12:46 a.m., on February 7, 2008, Deutsche Bank notified Rowe, Sun, and others, but not Premo, that on February 4, 2008, it had issued a notice that there is a potential for default, as to the NovaStar bond, that was recognized on January 30, 2008. Tr. 62, 64, 87-88, 321-22, 887, 893-94, 969; Div. Ex. 12. The event of default (EOD) gave the A1 Tranche the right to either liquidate the assets or accelerate payments.<sup>13</sup> Tr. 389. A Notice of Acceleration (Acceleration) would divert all cash flows to the A1 Tranche. Tr. 55.

Rowe considered the EOD a significant, very rare event, and has no doubt that he followed his regular practice and notified Premo as soon as he received the information. Tr. 322-25. Premo does not deny that Rowe's regular practice was to inform her, but she has no specific recollection of being notified. Tr. 90-91. As a result of the EOD, Premo directed research which disclosed that 57 percent of the underlying collateral for the NovaStar bond was insured subprime mortgages and she and Rowe concluded that they were worth their face value. Tr. 387-88. In a conversation with McCarthy on June 6, 2008, Premo stated that an EOD does not impact the underlying collateral. Tr. 947-48; Resp. Ex. 924 at 6. At the hearing she testified that the large percentage of mortgage insurance in the transaction was more important than the EOD. Tr. 948. There is nothing in the record that shows Premo or Rowe specifically informed the VC of the EOD. Tr. 96, 100-01, 135-40, 146, 149, 446-47; Div. Ex. 40.

On February 11, 2008, S&P circulated news of a downgrade of the NovaStar bond. Tranche A2 went from "AA+/WatchNeg" to B. Div. Ex. 18. Premo received the notice. Tr. 901.

2. On March 27, 2008, Deutsche Bank notified Rowe, Sun, and others, but not Premo, that it had issued an Acceleration on March 20, 2008, for NovaStar. Tr. 915-16, 969-70; Div. Ex. 22. Rowe considered this a significant event, and his practice was to pass all this type information on to Premo immediately on receiving it. Tr. 88, 91-92, 347.

Premo considered an acceleration or alteration in cash flows to be positive for senior bondholders because it prevented payouts to lower-rated holders while deals were winding down. Tr. 875-76, 884. She did not consider it a fact to be hidden. Tr. 884. Premo used the phrase "turbo'd the cash flows to the A1," to mean acceleration. Tr. 102. She believed that the VC understood these facts, and no one questioned the information she provided. Tr. 876-77. There is nothing in the record that shows Premo or Rowe specifically informed the VC of the Acceleration when it occurred. Tr. 96, 99-102, 135-40, 146-47, 446-47; Div. Ex. 40.

3. In May 2008, approximately, Rowe learned that the NovaStar bond Tranche A2 had missed an interest payment that was due under the original schedule on May 8, 2012. Tr. 348, 971. Rowe would have followed his regular practice and informed Premo of this fact. Tr. 350.

Rowe believes that he fulfilled his responsibilities to the VC by informing Premo of the EOD, Acceleration, and missed interest payment. Tr. 349-50. He believes this information should have been communicated to the VC, but he would not have done so without permission from

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<sup>13</sup> The EOD was a determination by the trustee that the bond was no longer overcollateralized because rating agencies downgraded the ratings on the CDO's individual component pieces. Tr. 102, 386.

Premo. Tr. 349. Rowe knew Premo was on the VC and that she spoke with Dennis Ferro (Ferro), Evergreen's CIO. *Id.* When he dealt with the VC in the February to June 2008 period, Rowe thought Premo had told the VC these facts. Tr. 365, 426. Premo estimates she and Rowe knew in April that the May interest payment would be missed, and that by May 8, 2008, it was factored into the portfolio management team's analysis. Tr. 56, 64, 91-92, 95. Premo maintains that the NovaStar bond did not default, and that this is a common misunderstanding. Tr. 1008.

There is nothing in the record that shows Premo or Rowe specifically informed the VC of the missed interest payment when it occurred. Tr. 96, 99-102, 135-40, 147, 446-47, 455; Div. Ex. 40.

### **Valuing the NovaStar Bond Tranche A2**

Typically, the portfolio management teams would produce an INTEXnet Analytics (INTEX) report, a broadly-accepted software program for evaluating CDOs, to establish the value of a position. Tr. 101-02, 125, 150, 199, 385, 522-23, 888; Div. Ex. 30. On January 30, 2008, Sun e-mailed Rowe an INTEX analysis that assumed various default levels in the underlying NovaStar collateral. Tr. 886-88; Resp. Ex. 14. Premo was not copied on the e-mail. Tr. 891; Resp. Ex. 14. Sun led the NovaStar pricing analysis using the INTEX model or platform that had the facts on the security based on the CUSIP number<sup>14</sup> for the specific security and adding assumptions for the default rate, prepayment rate, and discount margin or rate.<sup>15</sup> Tr. 355-59, 385-86. The INTEX analysis is a discounted cash flow analysis. Tr. 998. Premo had the final say on the information and assumptions used in running the INTEX model for NovaStar. Tr. 359-60. She testified that she did not control the portfolio management team's communications with the VC. Tr. 933. In the first half of 2008, Premo had a more positive view of the bond market than Rowe, and there were times when, according to Rowe, she changed the assumptions used in the model which resulted in a higher price.<sup>16</sup> Tr. 360-62. Premo testified that members of the portfolio management team frequently reviewed INTEX runs with members of the VC. Tr. 888.

Premo acknowledges responsibility as lead portfolio manager to inform the VC of the EOD and Acceleration. Tr. 983-84. The INTEX model for the NovaStar bond included the EOD, Acceleration, and missed interest payments as soon as the trustees gave notice, which altered the projected cash flows. Tr. 385, 391, 890-91. On May 22, 2008, an INTEX run showed on its face, if you knew how to read it, that only the A1 Tranche was receiving principal and interest payments and that all but the A1 Tranche had failed the overcollateralization test. Tr. 928-29; Resp. Ex. 514.

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<sup>14</sup> Committee on Uniform Securities Identification (CUSIP) assigns a nine-digit number to every stock and registered bond that trades in the United States. CUSIP is owned by the American Bankers Association and is operated by S&P.

<sup>15</sup> Another description of judgmental inputs to the INTEX model is the discount margin, expected loss, and recovery. Resp. Ex. 310.

<sup>16</sup> A post-event analysis by KPMG on June 27, 2008, found that Premo used a discount estimate of 31 to 36 percent for the INTEX analysis in the months of January, February, and March, when the defaults were 55 percent as of May 30, 2008. Resp. Ex. 310.

From the summer of 2007 through the first half of 2008, CDOs, which were not traded on an exchange, were becoming more challenging to value. Tr. 176. The value of the NovaStar bond became an issue in the summer of 2007, when the portfolio management team questioned the values provided by vendors. Tr. 117-18, 180-81, 219. Evergreen had bought the NovaStar bonds at close to \$100. Tr. 217. In July 2007, S&P dropped the price from the mid-90s to the mid-20s, and Evergreen challenged that price based on quotations from Lewis. Tr. 464-65; Resp. Ex. 118 at 3. S&P continued to lower its NovaStar valuations. Div. Ex. 29. McCarthy had the ability to question S&P or Lewis about bond values, but he left it to the portfolio management team to do so. Tr. 216-18. As a portfolio manager, Premo was “charged to do” valuations, and for almost every VC meeting, she provided valuation information for the NovaStar bond using INTEX cash flow analysis. Tr. 101-02.

Premo testified that the first time the portfolio management team was responsible for fair valuing the NovaStar bond was on June 4, 2008, and before that, brokers had set its fair value. Tr. 950-51, 983, 985. Other evidence is that the Ultra Short Fund portfolio management team began to fair value the NovaStar bond and override vendor value estimates, first with its own internal valuation and then with a broker quote, on July 25, 2007. Tr. 123-24, 133, 136, 213; Div. Ex. 4 at 9-14. The issue came before the VC because the method of establishing the fair value of the NovaStar bond changed from vendor to broker pricing and then to an internal value set by the portfolio management team. Tr. 259, 859-60. In this period, various persons at Evergreen asked questions about the NovaStar valuation and the Board received a memorandum describing fair-value pricing, which likely mentioned NovaStar. Tr. 219-21.

On August 31, 2007, Lewis agreed to send Evergreen daily price quotes for NovaStar. Div. Ex. 4 at 11. McCarthy or a co-worker looked at Lewis’s daily pricing positions on NovaStar bonds from sometime in 2007 until June 4, 2008, and the portfolio management team would comment on that price or would calculate a price internally that was generally close to Lewis’s price.<sup>17</sup> Tr. 195-96, 208, 214, 218, 248-49, 330-31.

On December 17, 2007, McCarthy e-mailed Phillips, Premo, and the portfolio management team, an inquiry from an Evergreen consultant noting a newspaper report that NovaStar Financial, a subprime mortgage lender, disclosed in a Commission filing that a waiver from a lender, Wachovia Bank, kept it from defaulting on credit agreements. Tr. 232; Resp. Ex. 117. The consultant asked what this meant to the NovaStar bond’s valuation. McCarthy stated in the e-mail “I believe that we continue to agree that the Lewis price represents the market much better than the S&P-23.209 on Friday,” and questioned whether the internal valuations had been run. Id.

On February 7, 2008, at 2:41 p.m., McCarthy informed Premo that Lewis’s price for the NovaStar bond had gone from \$89.03 to \$80.8 that day. Tr. 148; Div. Ex. 15. McCarthy also told Premo that S&P had the price at about \$13, that Sun told him that the position is “on credit watch negative from S&P,” and the auditors, KPMG, would be looking for an explanation of why the value used differed from the S&P value.<sup>18</sup> Tr. 245-46; Div. Ex. 15. Premo did not disclose the

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<sup>17</sup> The VC accepted the portfolio management team’s recommendation to use Lewis. Tr. 196-97. In May 2008, Lewis was pricing sixteen bonds for Evergreen. Resp. Ex. 213.

<sup>18</sup> In late January 2008, S&P adjusted their price to \$17.00. Resp. Ex. 310.



EOD to McCarthy when she responded to his e-mail at 3:52 p.m. that same day. Tr. 149; Div. Exs. 12, 15. Premo, Rowe, and Sun spoke with persons at KPMG “to get them comfortable about NovaStar” in February 2008.<sup>19</sup> Div. Ex. 4 at 13; Resp. Ex. 32; Tr. 901-12.

On February 8, 2008, Sun informed Rowe and Premo that a broker-dealer expected S&P to downgrade the NovaStar bond Tranche A2 to around BB, which is below investment grade. Tr. 338; Div. Ex. 17. On February 11, 2008, S&P e-mailed Premo that it had downgraded NovaStar Tranche A2 from AA+/Watch Neg to B. Tr. 340-41; Div. Ex. 18. On February 12, 2008, Lewis decreased the value of the NovaStar bond to \$72.31. Tr. 247-49; Resp. Ex. 211. McCarthy did not tell the VC that the NovaStar price dropped ten percent on two days in February 2008, and that the bond had moved to credit watch negative status. Tr. 250, 262-64. The Weekly Pricing Summary for 1/7/2008-2/22/2008 stated, “There has been no new information regarding this security.” At the beginning of March 2008, S&P adjusted its price to just above zero. Resp. Ex. 310.

The VC knew in the first half of 2008 that S&P valued the NovaStar bond at a level significantly lower than the one recommended by the portfolio management team which represented that S&P’s pricing assumptions did not reflect the fair value of the NovaStar bond. Tr. 459-60; Div. Ex. 29. On April 4, 2008, Premo circulated to Ferro and several VC members a letter from a broker, Sandler O’Neill & Partners, noting extraordinary current market dislocations and urging Commission guidance because every transaction of certain types of securities in the then-present market was a forced liquidation or distressed sale.<sup>20</sup> Resp. Ex. 3 at 2. The letter noted that certain CDOs backed by subprime mortgage collateral were trading at pennies on the dollar. Id.

None of the Weekly Pricing Summaries or VC minutes state that the NovaStar bond experienced an EOD, Acceleration, or missed interest payment. Tr. 137-42; Div. Ex. 4 at 9-14. McCarthy testified he would have included this information in those materials if he had been aware of it. Tr. 137-42. Premo received these materials but never mentioned to McCarthy that information was missing. Tr. 135-40.

### **Calhoun and Premo**

Calhoun was the CIO of the Tattersall Advisory Group (Tattersall), an Evergreen-owned adviser headquartered in Richmond, Virginia.<sup>21</sup> Tr. 584-86. From approximately September 2006 to December 2007, Calhoun had supervised Premo. Tr. 268, 588-90. After a corporate

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<sup>19</sup> Premo relies on this conversation with KPMG for her belief that the VC knew of the EOD in February 2008, but she could not identify anyone from Evergreen on the call beyond herself, Rowe, and Sun. Tr. 936-41, 995-98.

<sup>20</sup> The Pricing Procedures defined “fair value” as “the amount which the fund might reasonably expect to receive for the security upon its current sale, excluding transaction costs.” Div. Ex. 2 at 1. It also provided that “‘Fair Value’ determinations should be used when market quotations are not ‘readily available’ (or are unreliable) because of one or more of the following,” one of which is “Market valuations are ‘stale’ and there is no current trading activity in the security.” Id. at 2.

<sup>21</sup> Calhoun was with Tattersall from 1988 to 2009. Tr. 581-83. Tattersall was purchased by First Union in 1999. Tr. 585.

reorganization in December 2007, Calhoun and Premo were both CIOs. In 2007-2008, Calhoun led portfolio management teams in Richmond, and Premo did the same in Charlotte. Tr. 590, 659. Calhoun was the portfolio manager of the Core Plus Fund, and a portion of the fund's portfolio, a "sleeve," was managed by Premo's high-yield mortgage securities team. Tr. 595, 660. Calhoun was on the VC, but he did not attend the meetings regularly until the second quarter of 2008. Tr. 662, 665. On October 12, 2007, Premo sent Calhoun an e-mail stating that it would be helpful to get NovaStar "to get the downgrades past the turbo trigger such that the AAA would 'turbo' . . . we're bugging S&P to get us there." Tr. 882-84, 995; Resp. Ex. 505. Premo wanted the EOD to occur "because that preserves the cash flow in that transaction with the team of noteholders." Tr. 995.

In the first quarter of 2008, Calhoun and Premo began a serious disagreement on how to value fixed-income assets. Tr. 270-72. Calhoun believed that the NovaStar bond should be valued at market prices, while Premo believed that distressed prices did not accurately reflect the bond's value.<sup>22</sup> Tr. 270-71, 416. In March 2008, Calhoun investigated what assets were in the portfolio of a sleeve of the Core Plus Fund that Premo was managing. Tr. 600-03. When Calhoun learned that brokers ascribed significantly lower asset values than Premo reported, Calhoun contacted Ferro and Doug Munn (Munn), Head of Mutual Funds, and perhaps Abbas Riazati (Riazati), head of quantitative risk management.<sup>23</sup> Tr. 605-09; Resp. Ex. 900. Calhoun recognized that market values were disassociated from the fundamental intrinsic value of fixed-income securities, but he believed Evergreen's pricing procedures did not apply where markets were in uncharted territory and the situation was not temporary. Resp. Exs. 912 at 7, 950 at 10-12.

The VC took up the valuation issue on April 16, 2008. Tr. 605-07, 661; Div. Ex. 3. At the VC meeting, Munn advised that fire sale or distressed prices were not required if the securities did not have to be sold. Tr. 683-84; Resp. Ex. 950 at 16. The VC minutes cite a recent Trustees meeting where "it was discussed by counsel that distressed sales most likely do not represent an orderly market and should be considered but not be the determining factor for a current fair value price." Div. Ex. 3. Premo took these comments to mean the VC had no choice but to follow the procedures the Board had given and that she should "continue doing what we had always done, which was to use our models and our analytics and a thorough examination of the security, the collateral and analytics to come up with a fair value."<sup>24</sup> Tr. 921, 955; Resp. Ex. 950 at 16.

On May 9, 2008, Lewis told McCarthy that, based on INTEX and a cash flow analysis, it believed the quotes it provided represented the price at which the NovaStar bond would trade, and that it did not believe that distressed prices represented a fair price for the security. Resp. Ex. 228.

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<sup>22</sup> Rowe thought the market for asset-backed securities or structured products was distressed in the first half of 2008, and he would not have sold the Ultra Short Fund's assets at the fire sale prices. Tr. 375-76.

<sup>23</sup> Calhoun testified that Premo was on vacation and Rowe hung up on him. Tr. 605-06.

<sup>24</sup> The September 18, 2008, minutes of the audit committee of the Evergreen Trustees show that Evergreen rejected KPMG's \$45 valuation of the NovaStar bond as of April 30, 2008, and continued to believe in its fair value determination. Tr. 966-67; Resp. Exs. 308, 310.

On May 12, 2008, McCarthy sent the Board's Audit Committee a memo from the VC that stated:

As previously reported, one CDO position, NovaStar, held by 4 funds, representing 0.43%-1.61% of the funds' net assets, continues to be fair valued using a broker price instead of the vendor price. The price has been challenged but the vendor has not adjusted its price. The [VC] is obtaining other broker quotes periodically for comparative purposes and monitoring daily changes in the vendor price. The portfolio management team is monitoring the broker quote to ensure it reflects the security's fair value.

Resp. Ex. 8.

On May 14, 2008, McCarthy forwarded to Phillips, Premo, Rowe, Sun, and others, an inquiry from Calhoun questioning whether Evergreen was still pricing NovaStar at \$69. Tr. 18, 255, 690, 700; Resp. Ex. 110. Calhoun noted that S&P rated the A1 Tranche BB and the A2 Tranche B because the A1 Tranche got paid before the A2 Tranche. He also noted that on May 7, 2008, Guggenheim was unable to sell \$20 million of the A1 Tranche at \$9.5 because of a competing offer at \$7.25. Tr. 252-53, 701; Resp. Ex. 110. Calhoun sent the information to McCarthy because it was clear to him that Evergreen was significantly mispricing the bond. Tr. 691, 712. At the time, Calhoun did not know of the EOD. Tr. 693. Rowe was offended that Calhoun was trying to undermine the portfolio management team's pricing of NovaStar by circulating information about distressed level sales. Tr. 382-83.

On May 19, 2008, McCarthy circulated to Premo, Rowe, Sun, and others, a chart showing all securities that Lewis was pricing for Evergreen, which showed S&P's last vendor price on May 7, 2007, as \$0.008 and Lewis's price on April 30, 2008, as \$69.573. Resp. Ex. 213.

On or about May 22, 2008, Calhoun purchased \$166,000 of a C-Bass fixed-income CDO, similar to NovaStar in some respects, at \$9.50 for one of his funds. Tr. 272-73, 275, 610-12, 620, 733-34.<sup>25</sup> On May 27, 2008, Calhoun argued to the VC that in accordance with Evergreen's one-price policy, a C-Bass bond with the same CUSIP as the one he had purchased, held in funds managed by Premo, should be valued at \$9.50 and not S&P's last price of about \$98.00. Tr. 272-79, 620-21; Div. Ex. 3.

At a VC meeting on May 28, 2008, Rowe defended the portfolio management team's C-Bass valuation with an analysis of fundamentals and INTEx cash flows; the VC agreed with the portfolio management team's value for the C-Bass bond of \$61.0843. Tr. 276, 292-93, 527-31, 624, 747; Div. Ex. 3; Resp. Ex. 918. In answer to Phillips's questions, Rowe stated that the portfolio management team expected the C-Bass bond to fail the overcollateralization requirement and hit its triggers, and those things and downgrades were built into the cash flow analysis. Tr. 933-35; Resp.

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<sup>25</sup> Calhoun denied that his primary purpose in making the purchase was to create an issue of Premo's bond values before the VC. Tr. 734, 739-41.

Ex. 918 at 8-11. Premo was not at the May 28, 2008, meeting; she considered analysis of the C-Bass bond to be Rowe's responsibility. Tr. 932.

On May 30, 2008, McCarthy asked if NovaStar was on the list of securities selling at distressed prices and Premo replied "definitely." Resp. Ex. 928 at 8. Premo understood that McCarthy knew at this time "about the triggers and the event of default with regard to the NovaStar bond." Tr. 944.

On June 2, 2008, Phillips brought the valuation of the C-Bass bond value to the Board, which reversed the VC and valued C-Bass at \$9.50, but made it clear to the VC that it was not required to use distressed prices to fair value securities. Tr. 276-79, 532-33, 748-57; Resp. Ex. 214. Phillips testified that when the C-Bass bond was discussed in May 2008, she did not know that NovaStar had hit triggers. Tr. 536. Premo, however, testified that she understood in May 2008 that the VC "was aware of the fact that the NovaStar bond had hits its – failed its overcollateralization test, hit its triggers and was turboing to the payment classes – to the A1 tranche." Tr. 935. Premo's belief is based on the information she gave to the VC in July 2007 as to an EOD and triggers, which had not happened but were expected. Tr. 935-36.

In preparation for the June 4, 2008, VC meeting/vote, McCarthy sent the VC copies of the INTEX report and the following information provided by the Ultra Short Fund portfolio management team:<sup>26</sup>

The portfolio management team has reviewed the bond again this week. The PM team has updated their valuation assumptions. Changes have been made due to the most recent review of the collateral performance and market related spread widening. Default severities have doubled. With the new assumptions and a 500 DM, the INTEX run is now showing a price of \$53.7221. Using this price will impact the NAV by between \$0.005 and \$0.027 per share. Impacts to all funds are less than 0.275% of the NAVs.

Tr. 1000; Div. Exs. 31, 32. McCarthy did not tell the VC there had been an EOD, Acceleration, or missed interest payment as to the NovaStar bond because he did not have this information. Tr. 145-49.

Premo and Rowe were at the VC meeting on June 4, 2008. Tr. 538; Div. Ex. 3. Rowe thought he told the VC that: (1) NovaStar had failed its triggers, by which he meant the EOD and diverted cash flows; and (2) the INTEX cash flow analysis showed Tranche A2 would not be paid interest or principal until 2021 or 2022. Tr. 421-23; Resp. Exs. 935, 936 at 2, 937, 938 at 5. However, if these facts had been mentioned at the VC meeting, McCarthy would have included the information in the Weekly Pricing Summary and meeting minutes, and he did not. Tr. 146-47. Phillips testified that: (1) if Rowe had mentioned that the bond had failed triggers, she would not have understood the bond had experienced an EOD and missed an interest payment; (2) the VC did not understand that revenues were being diverted to other tranches and that it had missed a May

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<sup>26</sup> The Division contends this is the only INTEX run circulated to the VC. Tr. 1001; Reply Br. 16 n.5. Premo believes that INTEX runs were circulated to the VC in connection with the portfolio management team's analysis of broker fair valuations. Tr. 1002.

interest payment; and (3) from February to early June 2008, neither Premo nor anyone else informed her that the NovaStar bond had been the subject of an EOD, Acceleration, and missed interest payment. Tr. 435-36, 539.

On June 4, 2008, a majority of the VC voted to price the NovaStar bond using the portfolio management team's fair value price of \$53.72, rather than the broker price of \$67.47. Tr. 48, 145, 196, 264; Div. Exs. 3, 4 at 13, 31.

On June 5, 2008, McCarthy forwarded information to Premo and others about Goldman, Sachs & Co. (Goldman) prices for NovaStar Tranche A1, \$4.75 bid and \$7.25 ask, and questioned whether this information impacted the NovaStar Tranche A2 values that she had provided the VC, noting that the VC asked for all the data he had. Div. Ex. 33. Premo responded that the Goldman price was "stale" and should not be considered. Id. Later that day, Calhoun informed the VC that given Goldman's pricing, Evergreen's \$53 value for NovaStar was really pushing the "fair value" envelope. Tr. 629-30; Div. Ex. 34.

On June 6, 2008, McCarthy sent Premo, and Rowe, a "pass of what [he] was planning to send out" to the VC, for her review. Tr. 1027; Div. Exs. 35, 37. Premo's suggested changes did not disclose that the NovaStar bond had experienced an EOD, an Acceleration, and that a payment was not received on May 8, 2008, because, Premo testified, these things were common knowledge; thus, McCarthy did not convey this information to the VC on June 6, 2008. Tr. 164-68, 1029-32; Div. Exs. 36-38.

On June 9, 2008, Calhoun informed McCarthy and VC members Riazati and Michael Koonce, Legal, that the NovaStar bond had "defaulted on its May interest payment," and was in EOD status with all cash flows diverted to the A1 Tranche. Tr. 91-92, 631-32, 644; Div. Ex. 40.

That is likely why the pricing service wrote the bond off the day after the missed May coupon payment. The A1 will take significant principle writedowns (obviously that is why the A1 bond is offered at \$7.25) and the A2 bond is very, very likely worthless. I really do not want to be on a committee that is allowing this bond to be priced at \$53.

Tr. 286; Div. Ex. 40. Premo disagrees that a default occurred. Tr. 105. She references interest deferred, and that missed payments collect interest in arrears when they resume; her portfolio management team believed that the Acceleration would delay payments to Tranche A2 for thirteen years, and Rowe shared Premo's view that valuing bonds at then-present market levels would not be wise. Tr. 56, 58-59, 496-17.

Calhoun testified that he learned these facts very close to June 9, 2008, and that Premo's portfolio management team had not revealed this information to the VC. Tr. 633-34. McCarthy forwarded Calhoun's e-mail to the VC and others within hours of its receipt. McCarthy asked: (1) Calhoun if he recommended that the position be priced at \$0.00; and (2) Premo's team if the information was built into their analysis presented to the VC on June 4, 2008. Div. Ex. 40. McCarthy forwarded Calhoun's e-mail to the VC as "new information," and stated that on "last week's EVC call, there was no discussion regarding the A2 Tranche missing its May payment or cash flows being diverted to the A1 tranche." Tr. 144; Div. Ex. 40.

On June 9, 2008, Phillips directed a meeting at which Premo and Rowe could respond to these developments which “were not clearly stated at the [June 4, 2008,] meeting.” Tr. 18, 538; Div. Ex. 39. Phillips and Riazati testified they did not know before receiving Calhoun’s June 9 e-mail of the EOD, Acceleration, or missed interest payment with respect to the NovaStar bond, and Phillips agreed with McCarthy that Calhoun’s June 9 e-mail contained new information to the VC.<sup>27</sup> Tr. 14-15, 43, 443-44, 447, 458.

Premo thought Calhoun’s e-mail did not disclose new information. Tr. 953-54; Div. 41. By “not new,” Premo meant that the information had been factored into the portfolio management team’s calculation. Tr. 957. On June 9, 2008, Munn informed Ferro:

Dennis, I just got off the phone with Lisa. The data that Bob sent was not new and her team had factored it into their price. That is great news. I will fill you in with more detail tomorrow but wanted you to know (sic) that she thinks her evaluation is good. Down to differing opinions again.

Tr. 955; Div. Ex. 42.

Prior to a VC meeting on June 10, 2008, Rowe told McCarthy that he thought he had mentioned the bond “had failed its trigger,” but he did not say it had stopped paying interest and he expected the NovaStar Tranche A2 to be paid in full. Resp. Ex. 938. Rowe recognized that McCarthy and members of the VC were not “bond guys,” meaning they would not know the meaning of the phrase “failed its triggers.” *Id.* On June 10, 2008, the VC reduced the NovaStar bond value to zero. Premo was not at the meeting. Div. Ex. 3. The VC understood the portfolio management team’s INTEX analysis considered the delayed interest payments to arrive at a value of \$53.00 or \$54.00. Tr. 547-48; Resp. Ex. 920. The VC considered that it would be thirteen years before Tranche A2 would likely receive interest, and, in addition, the market was very illiquid. Div. Ex. 3. The VC heard arguments from Calhoun that Goldman was offering the A1 tranche at a bid/ask of about \$3.00 or \$4.00 and \$7.00, and that he considered the Tranche A2 worthless. Tr. 546-47. Phillips testified that on June 10, 2008, the VC had less confidence in information from the portfolio management team because it had not provided them with the information that Calhoun presented. Tr. 545-50. The drop in the NovaStar value caused the NAV of the Ultra Short Fund shares to fall from 9.07 on June 9 to 8.95 on June 10 and 8.83 on June 11. Tr. 170, 447, 449; Div. Ex. 4 at 14, 6.

The Board liquidated the Ultra Short Fund on June 18, 2008. Tr. 287, 569-70. After months of analysis and working with KPMG, Evergreen restated the NAV of some funds, including the Ultra Short Fund. Tr. 568. The NovaStar bond was sold for \$1,300 in November 2009. Tr. 287, 461.

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<sup>27</sup> Riazati did not generally receive information about missed payments, EODs, or Accelerations, as the head of Investment Risk. Tr. 34-36.

## Expert Testimony

Tamar Frankel (Frankel), the Division's expert,<sup>28</sup> views Premo as having two roles vis-a-vis the VC: one was as a voting member and the other was as a portfolio manager where she had a duty to provide the committee all relevant and material information regardless of her personal evaluation of the information. Div. Ex. 48 at 10; Tr. 799. Frankel testified that the EOD, Acceleration, and missed interest payment were all relevant and material information that Premo had a duty to disclose to the VC as soon as she learned of them, and that duty existed whether or not members of the VC already knew the information.<sup>29</sup> Div. Ex. 48 at 10-11. She cites the Investment Company Act's requirement to fair value securities as the source of the duty. Tr. 788. Frankel believes the integrity of the VC's work depended on it receiving all relevant and material information in establishing the value of the Ultra Short Fund's NovaStar position and that Premo had a duty to bring all important developments concerning NovaStar to the VC's attention in a timely manner. Div. Ex. 48 at 10; Tr. 815.

Frankel contends that Premo played a pivotal role in deciding what information went to the VC, and that she violated her duty to transfer information and instead set herself up as the judge of its significance. Div. Ex. 48 at 7; Tr. 791, 815. Frankel opined that Premo had a duty to inform the VC of the EOD because: (1) Premo was the lead portfolio manager; (2) the EOD was relevant and material information for the VC to perform its function; and (3) the VC needed the information as soon as possible to determine the proper value of the CDO securities held in the funds. Div. Ex. 48 at 7; Tr. 797-87, 815.

Frankel also opined that Premo had a duty to inform the VC of the Acceleration because it was a material development and the VC required this information to evaluate the security in terms of the probability that the A2 Tranche security holders would receive less than the full amount they would otherwise have been entitled to, or that they would receive the full amount, but at a much later date than originally anticipated. Div. Ex. 48 at 7. Frankel believes the Acceleration reduced the value of the Ultra Short Fund's Tranche A2 position and that Premo caused the VC to mis-evaluate the NovaStar bond in violation of its legal duties. Id. at 8. Frankel believes the portfolio management team's estimate that cash flows to Tranche A2 would likely not occur for ten years or more was relevant and material information that Premo should have disclosed. Id. at 9.

Frankel considers the INTEX report to be relevant and material, but only part of the information the VC should have received, and that Premo had a duty to the VC and its purpose of valuing securities to disclose the "aggregate" information. Id.

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<sup>28</sup> Frankel is a Professor at Boston University School of Law. She received a diploma from Jerusalem Law Classes in 1984, and a LL.M. and S.J.D. from Harvard Law School in 1964 and 1972, respectively. She has authored or co-authored nine books, many book chapters, and published an enormous number of articles on the duties of a fiduciary in the securities industry and related subjects. She has also provided expert testimony in seven matters. Div. Ex. 48.

<sup>29</sup> According to Frankel, "Ms. Premo's duty to inform did not depend on, and was not limited by, the information available to or known by the persons to whom her duty ran." Id. at 11.

Frankel deems Premo's failure to inform the VC that the NovaStar bond had failed to make a quarterly payment as quickly as possible to be a breach of Premo's disclosure obligation that caused the VC to breach its duty to fair value the NovaStar security. *Id.* at 8. As the portfolio manager of the Ultra Short Fund, Premo had a fiduciary duty to make full and fair disclosure of all material facts to the Board at the VC meeting on June 4, 2008. *Id.* at 9. In Frankel's opinion, Premo was required on June 4, 2008, to clearly and unambiguously convey to the VC that NovaStar had experienced an EOD, an Acceleration, and that the quarterly payment due on or about May 8, 2008, had not been paid. *Id.* at 9-10.

Frankel opined that Premo's ability to delegate did not absolve her from responsibility because people cannot delegate a duty. Tr. 831. "This lady sat on the committee. She knew what was coming in and she could very easily have told people to give information and to give it right away." Tr. 811-12. Frankel would not consider it appropriate for Premo to delegate her duty to inform the VC even if she were considered a Fund co-manager because each co-manager has the duty. Tr. 802. In Frankel's opinion, the fact that a portfolio manager who reported to Premo knew the facts, did not diminish Premo's duty of disclosure. Div. Ex. 48 at 12. Frankel saw a pattern of failure to disclose information to the VC that was very hard not to notice. Tr. 812. Frankel concluded that most people on the portfolio management team did not act without Premo's approval. Tr. 802.

## **Arguments**

### **The Division**

The Division argues that Premo: (1) engaged in fraudulent and deceitful conduct that willfully violated Sections 206(1) and (2) of the Advisers Act; (2) provided knowing and substantial assistance that willfully aided and abetted and caused Evergreen's violations of Sections 206(1) and (2) of the Advisers Act; and (3) willfully aided and abetted and caused the Ultra Short Fund's violation of Investment Company Act Rule 22c-1(a).<sup>30</sup> Div. Br. 1. The Division maintains that Premo was acting both as an investment adviser, i.e., a person compensated for giving investment advice to the Ultra Short Fund, and a person associated with an investment adviser, and that she violated Advisers Act Sections 206(1) and (2) by failing to satisfy the fiduciary duty she owed to the Ultra Short Fund by not disclosing to the VC material information – the EOD, Acceleration, and missed interest payment – about the NovaStar bond to the VC. Div. Br. at 22-24. According to the Division, Premo did not provide the VC with any information about these three critical events involving the NovaStar bond before June 4, 2008, and Rowe did not disclose this information because he thought Premo had. Div. Br. 26-27.

The Division maintains that Premo's portfolio management team's representations to the VC on June 4, 2008, which included an INTEX report, "did not adequately and completely inform the [VC] about the condition of the NovaStar CDO or about the significant negative events that had been affecting the CDO since at least February 2008." Div. Br. 24-25. The Division contends it is irrelevant that Premo and her team factored this information into the valuation analysis given to the

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<sup>30</sup> "Willfully . . . means intentionally committing the act which constitutes the violation." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Gearheart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)). One need not be aware that he or she is violating the law. *See id.*



VC, because the INTEX report did not satisfy Premo's fiduciary duty to disclose critical negative information that she had in her possession. Div. Br. 26-27. As support for its position, the Division accepts McCarthy and Phillips's testimony that Calhoun's June 9, 2008, e-mail contained new information about NovaStar's EOD, Acceleration, and missed interest payment. Div. Br. 28.

The Division supports the charge that Premo aided and abetted Evergreen's violations of Advisers Act Sections 206(1) and (2) with the following arguments. First, the Ultra Short Fund's NAV was overvalued from at least March to June 2008, because the NovaStar bond was mispriced. As a result of the mispricing, the Ultra Short Fund paid Evergreen higher advisory fees than Evergreen should have received. Div. Br. 29. Second, Premo had a responsibility to make sure that the VC had all the relevant information to ensure accurate pricing of NovaStar. Div. Br. 30. Premo knew, or was reckless in not knowing, that the VC did not have all relevant and material information. Id. The Division contends that Premo made a conscious decision not to provide the VC with material information relating to the NovaStar bond because she believed she knew the bond markets better than others, and it was the absence of this information that resulted in overpricing the NovaStar bond. Div. Br. 31. Third, Premo's actions were a proximate cause of the VC's pricing decisions concerning the NovaStar bond, and Evergreen's receipt of inflated fees. Id.

The Division relies on these same three elements to support the allegation that Premo caused Evergreen's violations. Id. The Division charges that Evergreen breached its fiduciary duty to and defrauded the Ultra Short Fund in violation of Advisers Act Sections 206(1) and (2) because Evergreen did not factor material negative information about NovaStar into its recommended NovaStar bond valuation, and thus it provided the Ultra Short Fund with an overstated NAV, which caused the Ultra Short Fund to pay Evergreen higher advisory fees than were warranted. Div. Br. 32. The Division argues that Premo knew or should have known that her conduct would result in the VC assigning an overstated value to the NovaStar bond, and that she caused Evergreen's violations of Sections 206(1) and (2) of the Advisers Act. Id.

The Division contends that because Evergreen caused the Ultra Short Fund to overstate its NAV, the Ultra Short Fund sold and redeemed its shares at prices higher than its current NAV and thus violated Investment Company Act Rule 22c-1, and that Premo aided and abetted and caused the violations because she failed to inform the VC of the NovaStar bond's EOD, Acceleration, and missed interest payment and she did not ensure that the portfolio management team's report to the VC on June 4, 2008, adequately referenced these developments. Div. Br. 33-34. The Division charges that Premo clearly knew or was reckless in not knowing that her conduct would cause the Ultra Short Fund's violations. Div. Br. 34.

The Division argues that Premo's arguments are: (1) based on misstatements of fact; (2) attempts to shift her fiduciary responsibilities to others; and (3) denials that information vital for the proper valuation of a security is material. Reply Br. 1-22. The Division views Premo's conduct in failing to carry out her fiduciary duty to disclose information as showing both an intent to defraud and recklessness as required for a violation of Section 206(1) of the Advisers Act. Reply Br. 23-24. It argues further that Premo was the proximate cause of Evergreen's overvaluation of the Ultra Short Fund and its resulting violations of Sections 206(1) and (2) and Investment Company Act Rule 22c-1. Reply Br. 25-26.

## Premo

Premo agrees that an EOD, Acceleration, and a missed interest payment are all important events as to a bond. Tr. 95-96. She believes that the portfolio management team “had conversations from time to time with the valuation committee about NovaStar, and we included everything we knew in our analysis.” Tr. 984. Premo contends that it would have been impossible for her, with her new duties beginning in December 2007, to provide the VC with detailed information daily for the several thousand fair-valued securities in Structure Products, and that she acted in good faith to do the best she could. Tr. 988-89. She thinks her responsibilities changed after June 4, 2008, when the portfolio management team took responsibility for fair valuing securities. Tr. 987. Premo believes that she could, and did, delegate some of her responsibilities, including her responsibility to provide the VC with information to value the NovaStar bond, to Rowe. Tr. 991, 1034.

Premo believes that she told the VC about the EOD and that information about the Acceleration was factored into the information presented to the VC using terms like “triggers” and “cash flows.” Tr. 991-92, 998-1000, 1032. Premo believes that she gave the VC the information, “we did not actually say [the] words [‘EOD,’ ‘Acceleration,’ and ‘missed payment’]. But it was always included in our analysis. When we knew about it, we anticipated it, we included it in our analysis, and we used a different term. Failing its triggers is the terminology we used.” Tr. 96, 100-03, 881, 999.

That’s not how we talked. We talked about triggers, we talked about cash flows. Always and forever from day one, that’s -- we did cash flow analysis, you know, and event of default is a legal term in the prospectus, it’s not something that we used on a daily basis.

But I would have used, you know, hitting a trigger, accelerating cash flows or something that we would use in the course of talking about cash flow analysis as saying that there was an event of default in this structure. I had already talked about that back in 2007.

Tr. 992. 2007 is before the EOD and Acceleration happened, but Premo believed they would happen. Id.

Premo denies that: (1) the Calhoun e-mail on June 9, 2008, disclosed new information to the VC; and (2) she had not disclosed these events. Tr. 104-05. Premo contends that the payment in May was not missed because the portfolio management team knew that a payment was not coming because of the Acceleration. Tr. 984. Premo thought that Fund Administration, which includes Phillips and McCarthy, and the VC knew the information that some VC members now say they did not know. Tr. 103-04, 935-36, 948.

Premo maintains that she did not violate Sections 206(1) and (2) of the Advisers Act because Lewis priced the NovaStar bond following the Board’s Pricing Procedures up to, and including, June 3, 2008, so that pricing is not subject to allegations of non-disclosure, and Premo “literally disclosed the NovaStar CDO’s EOD to the Pricing Administrator,” McCarthy, who had sole responsibility for providing information to the VC. Resp. Br. 46. Premo argues that she told

McCarthy that the NovaStar bond had suffered an EOD on June 6, 2008, and the Division cannot show that either Premo or Rowe, to whom Premo delegated pricing responsibility for the Ultra Short Fund, failed to disclose NovaStar's EOD earlier. Resp. Br. 48. Premo questions McCarthy's testimony that his Weekly Pricing Summaries did not mention the EOD because Premo did not inform him that it had occurred by noting that the Weekly Pricing Summaries did not mention several new or rare developments that occurred to the NovaStar bond. *Id.* Premo contends that the evidence leaves open the possibility that Premo or Rowe disclosed the EOD to McCarthy as early as February 2008. Resp. Br. 49. Premo also contends that she disclosed the EOD to McCarthy "as well as the substance of the EOD and its consequences – acceleration and cash flow deferral" via Rowe and circulation of the INTEX report. Resp. Br. 59.

Premo maintains that any INTEX-derived valuation apprised the VC of all the facts incorporated in the valuation and that Premo and Rowe disclosed the EOD, resulting Acceleration, and cash flow deferral through presentation and circulation of an INTEX report for the NovaStar bond that was the basis for their internal valuation. Resp. Br. 46-47, 51-52. Premo contends that the INTEX discounted cash flow analysis took into consideration all facts relevant to the NovaStar bond, and that persons at Evergreen, including members of the VC, had access to the INTEX data "which clearly set out the very information that Premo is accused of failing to disclose." Resp. Br. 49. Premo contends that Rowe explicitly disclosed the EOD, Acceleration, and deferred cash flows to the VC on June 4, 2008. Resp. Br. 49-50. Premo argues, again, that for most of the period from late 2007 to mid-June 2008, there can be no challenge to the NovaStar pricing based on failures to disclose by Premo or Rowe because the NovaStar bond was priced by Lewis and that its prices were derived from INTEX which took the relevant facts into account. Resp. Br. 50-51. Premo disagrees with Phillips and McCarthy that the information in Calhoun's June 9, 2008, e-mail was new information. Resp. Br. 51 n.15.

Premo insists that she exercised reasonable care in making disclosures about the NovaStar bond to the VC and was not negligent and that she did not possess the state of mind necessary to support a fraud violation. Resp. Br. 46-47, 51. Premo claims that the Division is changing disclosure from a reasonable care standard to one requiring a full understanding by all recipients. Resp. Br. 51 n.16. She insists that she reasonably believed that McCarthy and the VC knew about NovaStar's EOD, Acceleration, and resulting cash flow deferral prior to June 4, 2008. Resp. Br. 52, 55. Premo notes that 2008 was an extraordinary time of turmoil and crisis in markets for CDOs, that she had recently been promoted and given new responsibilities, and she had continually asked her superiors for additional support. Resp. Br. 58.

Premo argues that *express* references to an EOD, Acceleration, and missed interest payment are not material information because, among other reasons, the VC on June 10, 2008, did not base its decision to value the NovaStar bond at zero on these facts. Rather its decision was based on Goldman's value of Tranche A1 and the Board's earlier shift to market value for the C-Bass bond a few days earlier. Resp. Br. 59-63.

Premo argues that the Division has not shown she possessed the mental state required for a violation of Section 206(1) of the Advisers Act. Resp. Br. 63-64. She argues further that she did not aid and abet or cause violations of Sections 206(1) or (2) of the Advisers Act or Investment Company Act Rule 22c-1 because (1) there was no primary violation; (2) secondary violations of the Advisers Act and Rule 22c-1 require an overstatement of NAV and the Division has not shown

that the Ultra Short Fund's valuation was overstated; (3) as to aiding and abetting, the Division has not shown the Premo "substantially assisted" any primary violation; and (4) she lacked that state of mind necessary for any secondary liability. Resp. Br. 65-73.

Finally, Premo argues that no sanction should be imposed, but if one is imposed, it should be lenient. There is no need for a cease-and-desist order, any civil penalty should be at the lowest level because there was no fraud or unjust enrichment, and a bar would be disproportionate and excessive in light of Premo's personal history and efforts to protect Evergreen investors.

### **Legal Conclusions**

The issues set out in the OIP are whether Premo, by failing to disclose to Evergreen's VC the EOD, Acceleration, and missed payment relative to the NovaStar bond, and by failing to reference these developments in a June 4, 2008, report to the VC:

- (1) committed willful violations of Sections 206(1) and (2) of the Advisers Act;
- (2) willfully aided and abetted and caused Evergreen's violations of Sections 206(1) and (2) of the Advisers Act; and
- (2) willfully aided and abetted and caused the Ultra Short Fund's violation of Investment Company Act Rule 22c-1(a). See OIP at 7-8.

### **Sections 206(1) and (2) of the Advisers Act**

Section 206 of the Advisers Act is an anti-fraud provision, similar in spirit to Section 10(b) of the Securities Exchange Act of 1934.<sup>31</sup> Section 206 prohibits any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly from: (1) employing any device, scheme, or artifice to defraud any client or prospective client; and (2) engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. 15 U.S.C. § 80b-6(1), 6(2) (2011).

### **Premo's Defenses**

Premo's defense that she disclosed the EOD, Acceleration, and missed interest payment on the NovaStar bond in communications with McCarthy and to the VC is unpersuasive. First, there is no evidence that Premo informed the VC that the INTEX analysis she used to provide valuations considered the EOD, Acceleration, and missed interest payment on the NovaStar bond. Moreover, the INTEX report alone was insufficient to satisfy Premo's duty to disclose this material information. Div. Ex. 48 at 9. Finally, members of the VC first received copies of an INTEX report in preparation for the June 4, 2008, meeting; a person had to be familiar with an INTEX report to find information about an EOD, Acceleration, and missed interest payment from the

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<sup>31</sup> Barry P. Barbash & Jai Massari, The Investment Advisers Act of 1940: Regulation by Accretion, 39 Rutgers Law Journal 627, 629 (2008).

report; and the VC relied on Premo and Rowe because they knew the bonds best.<sup>32</sup> Tr. 549-50, 718-23.

Rather than bolster her defense, Premo's communications with McCarthy show that she did not provide him with material information even when he initiated a communication that required its disclosure. There are several examples in the record, but the most glaring are the following. On February 7, 2008, at 2:41 p.m., McCarthy brought to Premo's attention a precipitous drop in the price of the NovaStar bond. In her response, Premo did not inform McCarthy that the portfolio management team received notice of an EOD at 12:46 a.m. that very day. Premo cites to exchanges with McCarthy on May 30 and June 6, 2008, but Premo did not directly tell McCarthy that the NovaStar bond had experienced an EOD, an Acceleration, and a missed interest payment on either of these occasions. Premo's non-disclosure on June 6 is especially egregious because McCarthy gave Premo a draft of what he was going to transmit to the VC and she sent him suggestions to the text without mentioning the EOD, Acceleration, and missed interest payment. Premo's reliance on a conversation with representatives of KPMG in February 2008 is totally misplaced because she could not remember who besides the KPMG people was on the call. Finally, the unchallenged expert testimony is that Premo could not delegate her disclosure requirement, but even if she could have made Rowe her spokesperson, Rowe is not sure he mentioned triggers at the VC meeting on June 4, 2008, where fair pricing the NovaStar bond was the subject of discussion. In addition, even if Rowe did use the term "triggers," this general reference would not satisfy Premo's duty to disclose to the VC that the NovaStar bond had suffered an EOD, an Acceleration, and a missed payment.

### **Premo did not commit willful violations of Sections 206(1) and (2) of the Advisers Act**

Advisers Act Section 206 violations require that an investment adviser knowingly, recklessly, or negligently engage in fraudulent conduct toward a client or prospective client. An investment adviser is "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . ." 15 U.S.C. §80b-2(a)(11) (2011).

A person who was not registered as an investment adviser has been found liable pursuant to Advisers Act Section 206 based on compensation received for services provided to clients. Abrahamson v. Fleschner, 568 F.2d 862 (2d Cir. 1977). This situation often occurs where the investment adviser is deemed to be the alter ego of the associated person or the investment adviser is controlled by the associated person. See Montford and Company, Inc. d/b/a Montford Associates, and Ernest V. Montford, Initial Decision Release No. 457 (Apr. 20, 2012), 103 SEC Docket 53516, 53530 (citing John J. Kenny, Securities Act Release No. 8234 (May 14, 2003), 56 S.E.C 448, 485 n.54, aff'd, 87 F. App'x 608 (8th Cir. 2004) (unpublished) ("An associated person

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<sup>32</sup> Calhoun had an INTEX run of the NovaStar bond on May 22, 2008, that showed all principal and interest going to Tranche A1, but he testified he did not realize it showed the EOD, Acceleration, and missed interest payment, and that if he had known these facts, he would have probably passed the information on to the VC on May 23, 2008. Tr. 726-33; Resp. Ex. 514.

may be charged as a primary violator under Section 206 where the activities of the associated person cause him or her to meet the broad definition of ‘investment adviser.’”)).<sup>33</sup>

Mr. Montford was the 100 percent owner of the adviser and its president, CEO, and chief compliance officer. Montford, 103 SEC Docket 53517. Mr. Kenny was chair and CEO of the investment adviser, which he owned with his wife through a holding company. Kenny, 56 S.E.C 449. This situation is distinguishable from Montford and Kenny. The Ultra Short Fund had an agreement with Evergreen and it paid Evergreen for the advisory services it provided. Premo was not Evergreen’s alter ego, and she did not own or control Evergreen. She was an Evergreen employee who was the Ultra Short Fund’s lead portfolio manager, and in this capacity she owed a duty of good faith and full and fair disclosure to the fund, to Evergreen, and to the VC. The Ultra Short Fund was not her client, and the evidence is that Phillips, not Premo, communicated the fair value that the VC approved for the NovaStar bond to the Ultra Short Fund Board. There is no evidence of Premo’s direct dealing with the Ultra Short Fund Board. While it might be reasonable to consider Premo an investment adviser, in this situation, the Ultra Short Fund was solely Evergreen’s client.

It strikes me as illogical on these facts to hold Premo responsible both as an investment adviser and as a person associated with an investment adviser who as an employee aided and abetted and caused Evergreen’s Section 206 violation.

**Premo willfully aided and abetted and caused Evergreen’s violations of Sections 206(1) and (2) of the Advisers Act**

The next issue is whether Premo aided and abetted and caused Evergreen’s violations of Section 206(1) and (2) of the Advisers Act. A person associated with an investment adviser is defined in Advisers Act Section 202(a)(17), as “any partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser . . . .” 15 U.S.C. § 80b-2(a)(17) (2011).

Liability for aiding and abetting and for causing can be proven by the following: (1) an independent securities law violation committed by a third party; (2) the person who aided and abetted and caused, knew that his or her role was part of an overall activity that was improper; and (3) the aider and abetter and causer knowingly and substantially assisted the conduct that constitutes the violation. See Woods v. Barnett Bank, 765 F.2d 1004, 1009 (11th Cir. 1985); see also Investors Research Corp. v. SEC, 628 F.2d 168, 178 n.61 (D.C. Cir. 1980); IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980); Woodward v. Metro Bank, 522 F.2d 84, 94-97 (5th Cir. 1975); SEC v. Slocum, Gordon, & Co., 334 F. Supp.2d 144, 184 (D. R.I. 2004); Robert M. Fuller, Securities Act Release No. 8273 (Aug. 25, 2003), 56 S.E.C. 976, 984, petition denied, 95 F. App’x 361 (D.C. Cir. 2004); Russo Sec. Inc., 53 S.E.C. 271, 278 & n.16 (1997); Donald T. Sheldon, 51 S.E.C. 59, 66 (1992); William R. Carter, 47 S.E.C. 471, 502-03 (1981); Scott G. Monson, Investment Company Act

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<sup>33</sup> Kenny cites SEC v. Berger, 2001 U.S. Dist. Lexis 18448, \*28 (S.D.N.Y. Nov. 13, 2001), aff’d on other grounds, 2003 U.S. App. Lexis 3562 (2d Cir. 2003), where the associated person controlled the investment adviser, and SEC v. Gotchy, 981 F.2d 1251 (4th Cir. 1992) (unpublished) where the person was the president and half-owner of the adviser. Kenny, 56 S.E.C 448, 485 n.54.

Release No. 28323 (June 30, 2008), 93 SEC Docket 7517, 7522. A respondent who aids and abets a violation also is a cause of the violation under the federal securities laws. See Sharon M. Graham, 53 S.E.C 1072, 1085 n.35 (1998), aff'd, 222 F.3d 994 (D.C. Cir. 2000).

The first prong of the three-part test is satisfied because Evergreen violated Sections 206(1) and (2) by providing false and misleading advice of a material nature to a client which operated as a device, scheme, or artifice to defraud, and it engaged in a course of business that operated as a fraud or deceit over a roughly two-month period. Section 206 imposes a fiduciary duty on investment advisers, requiring an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to their clients. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191, 194-195 (1963). The fraud towards clients that Section 206 prohibits may involve affirmative misrepresentations or nondisclosure of facts, and the nature and extent of disclosure depends on the circumstances and reasonable expectations of the parties. See 2 Tamara Frankel & Ann Taylor Schwing, The Regulation of Money Managers, 13-17 (2d ed. Supp. 2007). An omitted fact is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding the matter before him. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

An EOD, an Acceleration, and a missed payment were material, relevant information as to the value of a \$13 million bond investment. Evergreen had this information through its employee, Premo, and through Rowe and Sun, who worked for her. The evidence establishes beyond any doubt that in the period February through June 9, 2008, including the June 4, 2008, report to the VC, Premo: (1) knew the NovaStar bond suffered an EOD in early February 2008, an Acceleration in late March 2008, and missed an interest payment to the Tranche A2 holders due on May 8, 2008; (2) knew this information was material to the work of the VC; and (3) did not communicate this information adequately to the VC when, as lead portfolio manager for the Ultra Short Fund and a member of Evergreen's VC, she had a duty to do so.

Premo acknowledges that she knew these important facts about the NovaStar bond and that she had a duty to disclose relevant information to the VC. Tr. 89-96, 983-84. Frankel's unrefuted expert testimony is that Premo had a fiduciary duty to inform the VC clearly of this information. Tr. 815; Div. Ex. 48 at 7-8, 10-11. McCarthy and VC members Calhoun, Phillips, and Riazati, each testified unequivocally that he or she did not know about an EOD, Acceleration, or missed interest payment on the NovaStar bond before the VC meeting on June 9, 2008, which focused on "new" information from Calhoun. Tr. 14-15, 42-43, 95-96, 99-102, 135-49, 322, 435-36, 443-44, 446-47, 455, 458, 503-04, 633-34, 768-71, 777-81, 812; Div. Ex. 40. There is no mention of the EOD, an Acceleration, or a missed interest payment in material furnished to the VC or in the VC minutes. McCarthy's uncontested and credible testimony is that he would have included this information in the information he provided to the VC if he had known about it, and he would have included it in the VC minutes if it had been discussed at the VC meetings.

Through Premo, Evergreen knew this information but did not consider it in determining the fair value of the NovaStar bond and thus failed its fiduciary duty to its client. Evergreen benefited from the Ultra Short Fund's improperly high NAV because its advisory fee was based on the Fund's NAV. When the Ultra Short Fund learned the information that Premo had failed to disclose, it restated its NAV. Tr. 448-49; Div. Ex. 6. The Ultra Short Fund Treasurer considered that Evergreen's action caused the Ultra Short Fund's shares to have been overvalued at least during the period March 27 to June 9, 2008, and that the overvaluation was caused by the failure of

Evergreen's VC to consider that the NovaStar bond had experienced an EOD, an Acceleration, and had missed an interest payment to the Tranche A2 bond holders. Tr. 448-50.

A violation of Section 206(1) requires a showing that a person acted with scienter, defined as a mental state consisting of an intent to deceive, manipulate, or defraud; intentional and reckless conduct have been found to satisfy the scienter requirement. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976); Vernazza v. SEC, 327 F.3d 851, 860 (9th Cir. 2003); SEC v. Blavin, 760 F.2d 706, 711-12 (6th Cir. 1985). A showing that a person acted negligently is sufficient to support a violation of Section 206(2).<sup>34</sup> SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992); SEC v. Moran, 922 F. Supp. 867, 896-97 (S.D.N.Y. 1996). Premo's state of mind is attributed to Evergreen since her conduct caused Evergreen's violations. See SEC v. Blinder Robinson & Co. Inc., 542 F. Supp. 468, 476 n.3 (D. Colo. June 8, 1982) (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096-97 nn. 16-18 (2nd Cir. 1972)). Premo acted with scienter or with intentional recklessness, because based on her high-level education in finance, her star portfolio manager status at a respected investment adviser, and her expertise in fixed-income securities, she knew or was reckless in not knowing that a failure to disclose relevant material information about a \$13 million bond to the VC would cause the adviser to violate its duty to its client. The thrust of Premo's argument is that the VC considered the information because she provided it. She does not make a strong argument that she was unaware the VC should receive the information.<sup>35</sup>

The second prong of the three-part test, which requires that the person who aided and abetted and caused, knew that his or her role was part of an overall activity that was improper, is satisfied because Premo knew, or was reckless in not knowing, that an EOD, Acceleration, and missed or delayed interest payment was material information in determining a bond's fair market value. Based on her education, experience, and her testimony, Premo knew, or was reckless in not knowing, that her failure to disclose NovaStar's EOD, Acceleration, and missed interest payment to the VC would mean that the VC would not consider this information in approving the fair value of the NovaStar bond. She knew or was reckless in not knowing that by not considering this information, Evergreen would violate its fiduciary obligation to provide clients with a fair market valuation after considering all material and relevant facts.

The third prong of the three-part test, which requires that the aider and abetter and causer knowingly and substantially assisted in the conduct that constitutes the violation, is satisfied

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<sup>34</sup> Negligence is defined as:

[t]he failure to exercise the standard of care that a reasonably prudent person would have exercised in a similar situation; any conduct that falls below the legal standard established to protect others against unreasonable risk of harm, except for conduct that is intentionally, wantonly, or willfully disregarding of others' rights. The term denotes culpable carelessness.

BLACK'S LAW DICTIONARY 1056 (7th ed. 1999).

<sup>35</sup> Only four pages of Premo's seventy-four page Reply Brief argue that "Additional Disclosures Proffered by the Division Are Not Material." Resp. Br. 59-63.



because Premo, acting knowingly or recklessly, caused the violation. Premo was the reason the VC was not told about the EOD, Acceleration, and missed interest payment and thus did not consider these facts in determining the fair value of the NovaStar bond. She controlled the Structured Products group and she decided not to disclose to McCarthy and the VC that the NovaStar bond had experienced an EOD, Acceleration, and missed or delayed interest payment.<sup>36</sup> Premo emphasizes that the NovaStar bond was fair valued by a broker until June 4, 2008; however, this does not change the fact that during this time Premo was obligated to inform the VC of material information that she had about the bond. Moreover, it appears that even when the broker was providing a fair value for the bond, the in-house portfolio management team opined on the bond's fair value.

For all the reasons stated, Premo willfully aided and abetted and caused Evergreen's violations of Sections 206(1) and (2) of the Advisers Act.

### **Investment Company Act Rule 22c-1(a)**

Investment Company Act Rule 22c-1 provides:

(a) No registered investment company issuing any redeemable security . . . shall sell, redeem, or repurchase any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security.

Investment Company Act Rule 2a-4 defines NAV and states in Rule 2a-4(a)(1) that securities that have market quotations readily available shall be valued at current market value and "other securities and assets shall be valued at fair value as determined in good faith by the board of directors of the registered company."

It is not certain what fair-market value the VC would have approved for the NovaStar bond if it had had all the relevant, material information and how that decision would have impacted the NAV of the Ultra Short Fund during this time period. The preponderance of the evidence, however, is that the fair value of the NovaStar bond would have been considerably lower, and this would have had a material impact on the fund's NAV. I reach this conclusion for the following reasons. The fair value of the NovaStar bond impacted the value of the assets held by the Ultra Short Fund. When the VC was informed of the EOD, Acceleration, and missed interest payment, it reduced the fair value of the NovaStar bond on June 10, 2008, to zero. The Ultra Short Fund's NAV dropped twelve cents between June 9 and June 10, another twelve cents between June 10 and June 11, and twenty-one cents between June 11 and June 12, 2008. In the period May 1 through June 9, 2008, the Ultra Short Fund's NAV had only fluctuated a few cents each day. Finally, after learning about

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<sup>36</sup> A great deal of evidence was introduced about the disagreement and in-fighting between Premo and Calhoun about whether a bond's fair market value should be based on fundamentals, including a cash flow analysis, or market value, in the first half of 2008 when the fixed-income markets were in turmoil. These disagreements have no bearing on whether Premo was obligated to disclose to the VC material and relevant facts about a bond in a fund for which she was the lead portfolio manager. She was.

NovaStar's EOD, Acceleration, and missed interest payment, the Treasurer of the Ultra Short Fund considered fund shares to be overpriced during the period March 27 to June 9, 2008. Tr. 449.

For all these reason, the preponderance of the evidence is that from at least March 27, 2008, when Evergreen received notice of the Acceleration, to June 9, 2012, the NAV of the Ultra Short Fund was inaccurate. Thus the Ultra Short Fund violated Investment Company Act Rule 22c-1(a) during this period because any sales, redemptions, or repurchases of securities it engaged in occurred at prices that did not reflect the NAV of the fund, and Premo willfully aided and abetted and caused the violations by her conduct described above.<sup>37</sup>

### **Sanctions**

The Division recommends that Premo be:

(1) ordered to cease and desist from committing or causing future violations of the relevant securities statutes, pursuant to Section 203(k) of the Advisers Act, 15 U.S.C. § 80b-3(k) (2011) and Section 9(f) of the Investment Company Act, 15 U.S.C. § 80a-9(f) (2011);

(2) ordered to pay a Third Tier civil money penalty, pursuant to Section 203(i) of the Advisers Act, 15 U.S.C. § 80b-3(i) (2011) and Section 9(d) of the Investment Company Act, 15 U.S.C. § 80a-9(d) (2011); and

(3) barred from associating with any investment adviser or serving in a variety of positions with a registered investment company, pursuant to Section 203(f) of the Advisers Act, 15 U.S.C. 80b-3(f) (2011) and Section 9(b) of the Investment Company Act, 15 U.S.C. § 80a-9(b) (2011). Div. Br. 34-39; Reply at 27.

Premo maintains that no sanction is warranted because she is not liable, but if she is found liable, the sanctions should be lenient since these events were one instance in an unblemished career spanning over two decades, and the Division has not demonstrated any fraudulent intent or impropriety or that Premo was unjustly enriched. Resp. Br. 73-74.

### **Cease and Desist**

Section 203(k)(1) of the Advisers Act and Section 9(f) of the Investment Company Act empower the Commission to issue a cease-and-desist order if, after notice and opportunity for hearing, a person was a cause of the violation of the statute. The Commission considers a cease-and-desist order appropriate considering the factors set out in KPMG Peat Marwick LLP, Exchange Act Release No. 43862 (Jan. 19, 2001), 54 S.E.C. 1135, 1185, petitioned denied, 289 F.3d 109 (D.C. Cir. 2002).

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<sup>37</sup> The record does not show specific sales, redemptions, and repurchases, but Premo agreed that the Ultra Short Fund was consistently ranked in the top of its fund category from its inception so it is reasonable to assume that transactions occurred during this period. OIP at 2; Answer at 2. Premo did not contest that transactions occurred.

Along with the risk of future violations, we will continue to consider our traditional factors in determining whether a cease-and-desist order is an appropriate sanction based on the entire record. Many of these factors are akin to those used by courts in determining whether injunctions are appropriate, including the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, 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 respondent's opportunity to commit future violations. In addition, we consider whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.

Id. at 1192.

Applying the KPMG criteria to Premo's situation is complex. On the negative side, Premo committed a serious violation magnified by Evergreen's status as a fiduciary, and her non-disclosure caused the Ultra Short Fund to overpay Evergreen for advisory fees and for some people to overpay for fund shares. On the other hand, Premo's conduct was not motivated by attempts to obtain personal financial gain; she had no prior regulatory violations in a lengthy securities career; the non-disclosures related to one bond and occurred in just over two months; Premo had too few employees and considerable responsibilities at a time when financial markets were in disarray; and a co-worker with strong views challenged the way she was valuing securities publicly with Evergreen leaders.

I found, based on observations and a review of the evidence, that Premo was a credible witness. She did not embellish or distort events or make excuses. Her position is based on her belief of what she thought others understood. Premo knew the EOD, Acceleration, and missed interest payment were used in the INTEX analysis used to produce cash flow projections that were used to value the NovaStar bond. I conclude that she did not specifically disclose these facts to the VC because they would have weakened her professional opinion that the market for fixed instruments was temporarily distressed and a cash flow analysis, rather than market value, remained the correct way to value the NovaStar bond. In a time of stress, Premo's ego overcame her duty to communicate information.

On balance, the seriousness of the conduct by someone working in a fiduciary capacity and harm to the public outweighs the positive evidence, and I find that a cease-and-desist order is appropriate to protect the investing public.

### **Third Tier Civil Money Penalty**

Section 203(i) of the Advisers Act and Section 9(d) of the Investment Company Act permit civil penalties in proceedings instituted under Section 203(f) of the Advisers Act, Section 9(b) of the Investment Company Act, or in any cease-and-desist proceeding if, after notice and opportunity for hearing, a person was found to have willfully aided and abetted or caused a violation of the statute.

The three tiers are distinguishable by characteristics and maximum amounts. Second Tier penalties are applicable where the acts or omissions involve fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. Third Tier penalties are applicable where the criteria for the Second Tier are present and, in addition, the acts or omissions “directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.” 15 U.S.C. § 80a-9(d)(2)(c)(ii) and 15 U.S.C. § 80b-3(i)(2)(c)(ii). The Debt Collection Improvement Act of 1996 fixes the amount of civil penalties under the Investment Company Act and the Advisers Act for violations occurring after February 14, 2005, and before March 3, 2009, as follows: the maximum penalty per act or omission for a natural person is: Tier One \$6,500; Tier Two \$65,000; and Tier Three \$130,000. 17 C.F.R. § 201.1003-1004.

Considerations used to determine whether a civil penalty is in the public interest include the Tier Two characteristics, harm caused to others, unjust enrichment, any previous regulatory or governmental determinations, deterrence, and such other matters as justice may require. 15 U.S.C. § 80a-9(d)(3) and 15 U.S.C. § 80b-3(i)(3). With respect to these indicia, Premo’s aiding and abetting and causing violations were done knowingly or recklessly with resulting financial damage to the Ultra Short Fund, which paid advisory fees that were too high, and investors who overpaid for fund shares for a little over two months.

On the other hand, there is no evidence that Premo acted with intent to benefit herself financially and there was no unjust enrichment. In fact, Premo’s actions have had a devastating adverse impact on her. As the result of this proceeding, Premo will be subject to a cease-and-desist order which will leave her professional reputation in tatters, and to defend her actions she has engaged legal counsel for years. Tr. 62. Evergreen’s Organizational Charts as of September 2, 2008, show Premo as one of six leaders under the heading “Investments.” Resp. Ex. 900. Rowe, who worked for Premo at a much lower level in the Evergreen organization, earned around \$700,000 by 2007, so it is reasonable to assume that Premo earned substantially more. Tr. 368-69. Evergreen no longer exists as a separate entity, but some Evergreen employees moved on to Wells Fargo. However, Premo made no mention of current employment in her testimony.

Given that there is no evidence of an intent to achieve personal gain, and, in fact, no unjust enrichment, the short time period when the violations occurred as to a single security, and the other measures ordered in this Initial Decision, it is not appropriate in the public interest to assess a civil money penalty.

**Bar From Associating With Any Investment Adviser or Serving In a Variety of Positions With a Registered Investment Company**

Section 203(f) of the Advisers Act authorizes the Commission, after notice and opportunity for hearing, to censure or place limitations on the activities of any person associated with an investment adviser at the time of the alleged misconduct, or suspend for a period not to exceed one year, or bar any such person from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, if such restriction is in the public interest and the person has, as relevant here, “willfully aided, abetted, counseled, commanded, induced, or procured” the violation by any other person of any provision of that title or the Investment Company Act.

Section 9(b) of the Investment Company Act states that the Commission may, after notice and opportunity for hearing:

prohibit, conditionally or unconditionally, either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, if such person . . .

(3) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of . . . title II of this Act, or of this title . . . or of any rule or regulation under any of such statutes.

Premo's aiding and abetting and causing violations bring her within the scope of Section 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act, and the question is whether it is in the public interest to restrict her future activities in the securities industry. Commission actions imposing restrictions are expected to serve a remedial purpose and to also deter wrongdoing. See Decker v. SEC, 631 F.2d 1380, 1384 (10th Cir. 1980); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 184 (2d Cir. 1976) ("The purpose of . . . sanctions must be to demonstrate not only to petitioners but to others that the Commission will deal harshly with egregious cases.")

The criteria for determining whether some type of measure allowed is in the public interest involves considerations very similar to the KPMG criteria - the egregiousness of a person's actions, the isolated or recurring nature of the violations, the degree of scienter involved, the sincerity of a person's assurances against further violations, a person's recognition of wrongdoing, opportunities to commit future violations, and deterrence. Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979); see also McCarthy v. SEC, 406 F.3d 179, 189 (2d Cir. 2005); Joseph J. Barbato, Securities Act Release No. 7638 (Feb. 10, 1999), 53 S.E.C. 1259, 1281 n.31; Donald T. Sheldon, 51 S.E.C. 59, 86 (1992).

For all the reasons stated in connection with imposition of a cease-and-desist order, I find that a five-year ban from association with an investment adviser and from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter are appropriate in the public interest. Despite an unblemished twenty-year record of outstanding performance, Premo's willful, knowing lack of judgment on one security for a little over two months is contrary to the standard required of someone in her position. "[T]he primary objective of the federal securities laws [is the] protection of the investing public and the national economy through the promotion of 'a high standard of business ethics . . . in every facet of the securities industry,'" Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 315 (1985) (quoting Capital Gains, 375 U.S. at 186-87).

## 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 December 5, 2012.

## Orders

I ORDER that, pursuant to Section 203(k)(1) of the Investment Advisers Act of 1940 and Section 9(f) of the Investment Company Act of 1940, Lisa B. Premo is ordered to cease and desist from aiding and abetting and causing future violations of Sections 206(1) and (2) of the Investment Advisers Act of 1940 and Investment Company Act of 1940 Rule 22c-1(a);

I FURTHER ORDER that, pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940, Lisa B. Premo is barred for five years from association with an investment adviser and from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice. See 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. See 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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Brenda P. Murray  
Chief Administrative Law Judge