

INITIAL DECISION RELEASE NO. 727
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15617

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

In the Matter of : ;
LARRY C. GROSSMAN and : INITIAL DECISION
GREGORY J. ADAMS : December 23, 2014
: ;
:

APPEARANCES: Patrick R. Costello and Sunny H. Kim for the Division of Enforcement, Securities and Exchange Commission

Zachary D. Messa and Michael T. Cronin, Johnson Pope Bokor Ruppel & Burns, LLP, for Larry C. Grossman

Mark David Hunter and Jenny D. Johnson-Sardella, Hunter Taubman Weiss LLP, for Gregory J. Adams

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on November 20, 2013, pursuant to Section 8A of the Securities Act of 1933 (Securities Act), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 (Advisers Act), and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). Both Respondents filed Answers denying the allegations in the OIP.

On April 7, 2014, the Commission entered an Order Making Findings and Imposing Remedial Sanctions Against Gregory J. Adams (Adams Settlement). *Larry C. Grossman*, Securities Act Release No. 9572, 2014 SEC LEXIS 1261. The Adams Settlement: (1) ordered Gregory J. Adams (Adams) to cease and desist from committing or causing any violations and any future violation of Securities Act Section 17(a), Exchange Act Section 15(a), and Advisers Act Sections 206(1) through 206(4), and 207 and Advisers Act Rules 204-3 and 206(4)-2; (2) barred Adams from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization;

(3) prohibited Adams 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; (4) set out conditions to be considered in any reapplication for association by Adams; and (5) stated that Adams shall pay disgorgement and third-tier penalties in amounts to be determined by additional proceedings.

During a four-day hearing in March-April 2014, the Division of Enforcement (Division) presented seven witnesses, including Larry C. Grossman (Grossman) and Adams. Grossman presented three witnesses. Approximately 150 exhibits were admitted into evidence. The last brief was filed on July 11, 2014.¹

At the March 7, 2014, prehearing conference, Adams and the Division agreed to determine disgorgement and civil penalties on the papers. Prehearing Tr. 19-21. I agreed to set a schedule for a motion for summary disposition on the issues of disgorgement, prejudgment interest, and civil penalties. Prehearing Tr. 28. On August 19, 2014, I granted the Division's Consent Motion for Proposed Summary Disposition Briefing Regarding Adams and set a procedural schedule to determine these issues.² *Larry C. Grossman*, Admin. Proc. Rulings Release No. 1711, 2014 SEC LEXIS 2968. The Division filed its Motion for Summary Disposition (Motion) on September 30, 2014, attaching as Exhibit A, the Declaration of Kathleen E. Strandell (Strandell Declaration) and Exhibit B, the Adams Settlement, which I admit into evidence. Adams filed his Opposition on October 31, 2014, attaching the Declaration of Gregory J. Adams as Exhibit 1, which I admit into evidence. The Division filed its Reply on November 18, 2014.³

Issues

As to Grossman, the issues are whether he: (1) willfully violated the Securities Act and Advisers Act by fraudulent conduct in the offer and sales of securities and as an investment

¹ I will cite to the transcript of the hearing as "Tr. ____." I will cite to the Division's and Respondent's exhibits as "Div. Ex. ____." or "Resp. Ex. ____." I will cite to the Division's and Grossman's posthearing briefs as "Div. Br." or "Resp. Br." I will cite to the Division's Reply brief as "Div. Reply." As to Bates-stamped pages of exhibits, I will cite to those pages without reference to the prefix. For exhibits without page numbers, I will consider the first page as one and count from there.

² I find *Jay T. Comeaux* inapplicable here because the Division's Motion was supported with sufficient evidence on the disgorgement amount. Securities Act Release No. 9633, 2014 SEC LEXIS 3001, at *8-18 (Aug. 21, 2014) (finding that when the Division's approximation of a respondent's gains from violative conduct is based on an expert's analysis of specific financial records, the Division must submit sufficient evidence to assess the reasonableness of that analysis).

³ I will cite to the Division's Motion for Summary Disposition against Adams as "Div. Motion," Adams's Opposition as "Adams Opp.," and the Division's Reply as "Div. Reply as to Adams."

adviser; (2) willfully violated the Exchange Act as an unregistered broker-dealer, and willfully aided and abetted and caused violations of the Exchange Act registration provision; (3) willfully violated the Advisers Act by acting as a broker for a person other than his investment adviser clients and knowingly effecting a sale or purchase of securities for his clients without disclosing the capacity in which he was acting and not getting the consent of the clients in writing before the transaction was completed; (4) willfully aided and abetted and caused violations of the Advisers Act and its rules by fraudulent, deceptive, or manipulative conduct; and (5) as a result of this conduct, willfully made untrue statements of material fact in Commission filings. OIP at 15-16.

As to Adams, the issues are the amount of disgorgement and third-tier civil penalties to be assessed.

Findings of Fact

The factual findings and legal conclusions 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, 101-04 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

Larry C. Grossman

Grossman holds a degree in business from Eckerd College in Florida. Tr. 631. Grossman holds Certified Financial Planner and Certified Investment Management Analyst designations. Tr. 630-33. From 1998 until October 1, 2008, Grossman was the founder, managing partner, and sole owner of Sovereign International Asset Management, Inc. (Sovereign), a limited liability company, incorporated in Florida in 2001. Tr. 168-69, 171; Div. Ex. 1. Sovereign was registered with the Commission as an investment adviser from June 21, 2002, through at least July 7, 2011, the date it filed its last Form ADV Part I with the Commission. Tr. 170; Grossman Answer at 2. Grossman was registered as an Investment Adviser Representative of Sovereign from September 5, 2006, through December 31, 2011. Div. Ex. 2. Sovereign used the means and instruments of interstate and international commerce to conduct business, including telephone calls, email, wire transfers, and the Internet.

The actions of Sovereign are attributable to Grossman because Sovereign was basically a one-person operation with Grossman responsible for all of its activities from its inception until October 1, 2008, and the evidence is that even after that date he had major responsibilities with Sovereign and its affiliates. Tr. 937; Grossman Answer at 1-2. Sovereign had a staff of less than ten, almost all support positions; no one was a registered representative of a broker-dealer. Tr. 639-40; Grossman Answer at 2; Div. Ex. 34 at 6; Div. Ex. 35 at 6; Div. Ex. 37 at 6; Div. Ex. 38 at 6; Div. Ex. 39 at 6; Div. Ex. 40 at 6; Div. Ex. 78 at 6; Div. Ex. 83 at 6; Div. Ex. 84 at 6.⁴ In

⁴ Citations to Forms ADV Part I will cite to the page number stated on the form, not the page number of the printed-out document, unless noted otherwise.

October 2008, Sovereign had about 500-700 clients with around \$85 million in assets under management. Tr. 453, 640.

Grossman also founded Sovereign International Asset Management, LLC (SIAM LLC), in Anguilla in 1999; Anchor Holdings, LLC (Anchor Nevis), in Nevis in 2004; and Anchor Holdings, LLC (Anchor Florida), in Florida in 2005 (with Sovereign, collectively the Sovereign Entities).⁵ Tr. 170, 173. Grossman used Anchor Florida to pool Sovereign's clients' funds prior to making certain investments. Tr. 225-26.

According to Grossman, Sovereign specialized in offshore asset protection planning, mainly by taking individual retirement accounts (IRAs) and other retirement plans offshore, and promoting international investments. Tr. 189, 630, 634-35; Dp. 14.⁶ Grossman considered himself very knowledgeable on these subjects and, according to his account, he frequently spoke at conferences, published more than one hundred articles, contributed to Fox Business News, and wrote a book promoting his ideas. Tr. 189-90, 643.

In 2006, Grossman formed Sovereign International Pension Services, Inc. (SIPS), an IRA administrator, as taking retirement plans offshore became a larger part of his business and he believed he knew more about the process than many of the IRA custodians he worked with.⁷ Tr. 177, 636. SIPS handles IRA administrative paperwork and ensures compliance with U.S. laws. Tr. 637-38.

Grossman's alleged investment philosophy is based on the concept of sector and style rotation. Tr. 646. According to this theory, the economy operates on a cycle, and depending on where in the cycle the economy is, certain investments are predicted to do well while others are not. Tr. 646. Grossman testified that he used underlying statistical data to determine where in the cycle the economy was and made investment recommendations based on that part of the cycle. Tr. 646; Resp. Ex. 99 at 3-9; Div. Ex. 46D at 3-9. Grossman communicated his investment strategy and generated business through speaking engagements, Sovereign's website, newsletters and other publications, proposals, and meetings. Tr. 196-97, 635, 643, 646-47; Div. Ex. 44; Div. Ex. 46B; Div. Ex. 46D; Resp. Ex. 99.

Grossman told Sovereign's clients that he "use[d] an extensive investment selection process that [was] not only quantitative but incorporate[d] a significant due diligence process as well." Div. Ex. 46B at 1; Tr. 51. Grossman represented that Sovereign used

⁵ There is considerable confusion in the record about names. Grossman refers to Sovereign as SIAM and the Division refers to it as Sovereign. SIAM LLC is a separate entity.

⁶ See *infra* note 34.

⁷ No certification is required to become an IRA administrator, although an administrator needs to be able to work with a qualified custodial bank. Tr. 178. SIPS currently has around 750-1000 clients, and while Sovereign was operating, there was some overlap between both companies' clientele. Tr. 641.

proprietary investment methodologies to systematically deploy and manage capital in a variety of strategies across equity, hedge funds, futures and currency markets around the world. [Sovereign] systems are designed to be risk-adverse while at the same time being able to deliver above average returns.

[Sovereign's] process is driven by the investment strategy mandate. This mandate addresses client specific details such as current and future financial requirements, risk tolerance, return expectations, income needs and time horizons to provide a roadmap to meet each client's goals. . . .

Based upon the mandate, a customized plan is implemented which drives the investment selection. The plan is designed to deliver the optimal return for the client's acceptable level of risk. . . .

Div. Ex. 46B at 1.

Grossman represented that Sovereign's goal was to "deliver services, which provide highly personalized and individually tailored solutions" and they accomplished this by "giving extra effort to addressing client needs." Div. Ex. 50A. When he designed portfolios for clients, he told clients he would consider what they already owned, what they needed, their risk tolerances, and whether they were conservative investors. Tr. 220.

Most of Sovereign's clients were retirees, many of whom were novice investors. Tr. 23, 27-28, 33, 67, 101-03, 107; Div. Ex. 50 at 1; Dp. 8; Dp. Ex. 21 at 1. These clients relied on Grossman's credentials, experience, and representations in deciding to invest their money with Sovereign. Tr. 26-27, 50, 106, 119; Div. Ex. 50 at 1, 3-4; Dp. 51. Clients particularly liked the fact that Grossman represented that he examined each client's individual situation and targeted an investment program specifically for that person. Tr. 28; Div. Ex. 50 at 1. Sovereign clients notified Grossman that their investment goals were to protect core assets, make safe and low-risk investments, and achieve good returns. Tr. 29, 32-33, 102-03, 105, 539-40; Div. Ex. 50 at 1; Div. Ex. 50L at 1; Dp. 22; Dp. Ex. 3.

Despite Grossman's representations regarding the individuality of Sovereign's portfolio planning process and his due diligence, Grossman advised Sovereign clients to invest primarily in funds managed by Nickolai Battoo (Battoo). Tr. 353-54, 453; Div. Ex. 50 at 4; Div. Ex. 50K (10% gold, 10% split among three notes, 10% FuturesOne C, 35% Anchor A, 35% Anchor C); Dp. 38; Dp. Ex. 5 (15% exchange traded funds, 15% split among three notes, 35% Anchor A, 35% Anchor C); Dp. Ex. 20 at 1-2; Resp. Ex. 105 (60% Anchor A, 20% precious metals, 20% principal protected notes and exchange traded funds); Resp. Ex. 121; Resp. Ex. 134. Sovereign advised that these investments were "moderately conservative" or low risk and would provide improved returns over past investments for reduced risk and volatility. Tr. 48-51, 106, 118-19, 154; Div. Ex. 46D at 11; Dp. 22; Resp. Ex. 99 at 10. Grossman represented that the hedge fund investments were "highly diversified with different managers, styles and strategies"; that a portfolio containing 35% Anchor A and 35% Anchor C was "moderately conservative"; and that Anchor A was suitable for "widows and orphans." Div. Ex. 46D at 10; Div. Ex. 50 at 3; Div. Ex.

64 at 1; Dp. Ex. 5; Resp. Ex. 99 at 10. When Grossman sold Sovereign in October 2008 to Adams, 75% of Sovereign clients' assets were invested in the Battoo Funds. Tr. 453, 482-83.

Gregory J. Adams

Adams bought Sovereign and three other related entities from Grossman in October 2008, for \$3.8 million, with \$500,000 due at closing, \$500,000 due six months after closing, and the balance represented by a promissory note bearing an 8% interest rate per year.⁸ Tr. 174-76, 452-53, 494, 634; Div. Ex. 1 at 1-2; Grossman Answer at 1. In part, the contract provided that the sale of Sovereign would not "materially adversely affect the relationships" of Sovereign with its clients and that Sovereign would have the option to rent its current office space from Grossman for at least one year. Div. Ex. 1 at 7, 10.

Adams attended Geneva College and earned a degree in business administration and biblical studies. Tr. 493. He holds a Certified Financial Planner designation and had previously been a series 6 representative with State Farm Mutual Funds and Nationwide Mutual Funds. Tr. 493-94. Adams worked with Grossman at Sovereign around 1999-2000 for about one or one and one-half years. Tr. 494.

After the sale, Adams asked Grossman to stay on as a consultant to help with the transition; according to Grossman, he was paid an agreed-upon salary that was not tied to Sovereign's or any investment's performance. Tr. 759, 761-62. Sovereign and SIPS continued to share office space, supplies, personnel, and computer systems. Tr. 569, 576-77, 591-92, 594-95. SIPS also continued to serve as IRA administrator for some of Sovereign's clients. Tr. 177-78. Grossman testified that after the sale, he did not have any decision-making or management authority and he was not able to sign off on checks on behalf of Sovereign. Tr. 761-62.

Sovereign filed for Chapter 7 bankruptcy in the United States Bankruptcy Court for the Middle District of Florida on June 28, 2012, and the State of Florida administratively dissolved Sovereign at the end of September 2012.⁹ OIP at 2, Adams Answer 1-2. *In re Sovereign Int'l Asset Mgmt., Inc.*, No. 8:12-bk-9978-CPM (Bankr. M.D. Fla).

Adams filed a Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Middle District of Florida on May 15, 2013. *In re Gregory James Adams*, No. 8:13-bk-6411 (Bankr. M.D. Fla.).

Grossman's Post-Sale Work for or Contacts with Sovereign

⁸ Grossman did not sell SIPS. Tr. 177. At least one Sovereign customer did not realize that SIPS was a separate company, as they had the same logo and the same employees signed up clients for both services. Tr. 147-48. A Sovereign employee testified that a person would have difficulty distinguishing between Sovereign and SIPS in their shared office. Tr. 596. As of March-April 2014, Grossman continued to own and operate SIPS. Tr. 177; Answer at 1.

⁹ According to the Florida Department of State Division of Corporations website, Sovereign was dissolved on September 28, 2012, of which I take official notice pursuant to Commission Rule of Practice 323. 17 C.F.R. § 201.323.

Grossman did not clearly express to Sovereign's clients that he had sold the business to Adams. Div. Ex. 50 at 7; Tr. 52-54, 76-77, 81, 134-35, 137, 140-41, 164-65. After October 1, 2008, Grossman continued working as if he was still with Sovereign; for instance, on October 13, 2008, Grossman sent a letter on Sovereign letterhead to an investor, notifying him that Sovereign did not have an Investment Advisory Agreement (IAA) on file for him and requesting the client's signature. Dp. 77; Dp. Ex. 12.

On October 14, 2008, Grossman sent an email from Adams's email address, stating,

I would like to introduce you to my good friend, Greg Adams. Greg and I have known each other for over 25 years and Greg helped me start Sovereign back in 1999. . . .

Greg has been named President and Chief Investment Officer of [Sovereign] and has assumed full responsibility for the asset management side of the business. I continue to remain on the Board of Advisors for the company. I will be advising Greg on both my worldview, as it relates to investments, and in the latest asset protection strategies.

I have been and remain Managing Director of [SIPS], responsible for the Pension side of the business. I want to assure you my office is only a few doors down from Greg's office and I will be actively involved in the day-to-day strategy development as needed. You will see no interruption in the global perspective of Sovereign's investment strategies. Because of Greg's previous tenure, he is extremely knowledgeable in all aspects of the company and I am 100% confident these moves will continue to improve our business and the service we provide for you. . . .

I ask that you give both Greg and I the continued privilege of serving you and your investment and asset protection needs. I know that [Sovereign] and [SIPS] can continue to help you find those exciting and unique global investment opportunities that exist even in these challenging times.

Div. Ex. 64 at 2. The email did not explicitly state that Grossman had sold Sovereign. One investor states that he has never received express notice, written or verbal, from Sovereign, Grossman, or Adams that Grossman had sold or even contemplated selling Sovereign. Div. Ex. 50 at 7. The investor only learned of a change in management at Sovereign in late November 2008, when he was called by Adams to discuss an issue with his Anchor C investment. *Id.* Another investor, who testified on Grossman's behalf, only learned that Grossman had sold Sovereign after Sovereign informed its clients about Anchor A's involvement in the Madoff Ponzi scheme. Tr. 527-28. Investors continued to think of Grossman as their investment advisor as late as 2009 or 2010. Tr. 54-55, 98, 137, 140-41, 143, 161.

After he sold Sovereign, Grossman remained on the payroll as a consultant. Tr. 454; Div. Ex. 48 at 1-3. He assisted Adams with transitioning the business and interacting with Sovereign clients after the financial markets issues in late 2008 through early 2009. Tr. 454, 496, 759-61.

Grossman's signature was on Sovereign's December 23, 2008, filed Form ADV, and he was listed as Sovereign's contact employee. Div. Ex. 84A at 3, 30.¹⁰ Adams's name and other information appear to be crossed out in the document. *Id.* at 3, 30. Grossman denied digitally signing the document. Tr. 423-24. Adams did not know why Grossman's signature was on the document, but recalled a problem with the website and getting the Form ADV under his own name. Tr. 464-66. Adams testified that he had not intended to put Grossman's name on the document. Tr. 466.

On January 16, 2009, Adams notified Sovereign clients that "Larry Grossman has rejoined [Sovereign] as our managing director. He will be working closely with our asset management committee. We welcome him back in this capacity." Div. Ex. 151 at 11. Adams testified that after he bought Sovereign, Grossman did not render any investment advice for any Sovereign clients. Tr. 496-97. Grossman would assist Adams by suggesting types of investments to Adams and helping Adams in dealing with clients. Tr. 497. However, Adams was not always present when Grossman interacted with clients and was not aware of the substance of his communications. Tr. 498.

On February 11, 2009, Grossman forwarded to Adams an email chain between himself and a potential investor who was looking for recommendations with "all the world financial turmoil." Div. Ex. 120 at 67050. Grossman wrote to Adams,

Randy had me review their plan document to ascertain if they would be able to take it offshore, which they are. I mentioned most of the clients we deal with ultimately need assistance in deciding where to invest once the funds are offshore. Would you be so kind as to prepare a proposal for Randy. He is very interested in our approach.

Id.

On February 19, 2010, Grossman commented to Adams on a client interaction between Adams and a Sovereign client: "You missed a big one you should go back and clarify. See me or send me an IM I would rather not put it in an email." Div. Ex. 123 at 67055.

On December 16, 2010, Grossman offered to help Adams "get your business running in a better way for you and get you back on the road to success." Div. Ex. 119 at 67046.

The Nickolai Battoo Funds¹¹

¹⁰ The page numbers for Division Exhibit 84A are in the top left corner of the page.

¹¹ The Commission brought an enforcement action against Battoo and his companies on September 6, 2012, alleging, among other things, that he exaggerated the value of the assets he

Grossman met Battoo, the principal of BC Capital Group, S.A. (BC Panama) and BC Capital Group Limited (BC Hong Kong) (collectively BC Capital), at a conference in Panama, in 2002. Tr. 235, 662; Div. Ex. 18 at 4; Div. Ex. 21 at 7, 42. Grossman testified that Battoo explained that he was managing his own commodities futures fund, he was registered with either the National Futures Association or the Commodity Futures Trading Commission, and his funds might be an appropriate fit with Grossman's investment strategy. Tr. 662-63. Grossman testified that he performed due diligence on Battoo's funds, including reviewing various documents and presentations associated with each specific fund. Tr. 249-50, 266, 268, 426-27, 431, 433, 436, 438, 440, 442, 444, 752-53, 845-46; *see* Div. Exs. 21, 25, 28-33, 66-67, 69; Resp. Exs. 28, 30, 35, 38, 41, 43-44, 46-47, 49-50, 55, 62. Grossman testified that one way he conducted due diligence was by traveling to Chicago and meeting with Battoo in the offices of Man Financial, where Battoo claimed he and his partner maintained an office, and discussing Battoo with several parties. Tr. 662-63; *see* Resp. Ex. 90. In addition, Grossman reviewed the "PerTrac" report, a monthly one-page snapshot of the performance, composition, and basic information about a hedge fund or managed account, produced by the funds' independent administrators. Tr. 283, 286-87, 668-69, 671, 681-82, 845-46; *see* Div. Ex. 63; Div. Ex. 70; Resp. Ex. 63. According to Grossman, he found a PerTrac report reliable because an independent fund administrator's job is to determine if all the information related to the fund, such as the fund statistics, is accurate. Tr. 669-70. Grossman claimed he was not aware whether Battoo was the source of the underlying information included in the report. Tr. 838-39.

Starting in August 2003, Grossman recommended funds Battoo managed through BC Capital almost exclusively to Sovereign clients. Tr. 354; Div. Ex. 50 at 4; Dp. 38. These included several offshore hedge funds, including Anchor Hedge Fund Limited (Anchor Hedge Fund) and FuturesOne Diversified Fund Limited (FuturesOne), as suitable investments for client retirement accounts. Tr. 202, 217, 662. Grossman also recommended Private International Wealth Management (PIWM), through which Battoo offered managed account services, to Sovereign clients.¹² Tr. 202, 217, 662.

Before 2005, Sovereign instructed clients investing in one of the Battoo Funds to wire transfer their investment to SIAM LLC and in 2005 and later, to wire transfer the investment to a

managed and in 2008 concealed major losses from investors due to investments in Madoff "feeder funds" and Battoo's termination from a fund linked certificate program. *SEC v. Battoo*, No. 1:12-cv-7125 (N.D. Ill.); *see* Div. Ex. 18. On September 30, 2014, the court granted the Commission's motion for entry of a final judgment of permanent injunction and other relief by default against Battoo and his companies, entering a permanent injunction from violating the federal securities laws and imposing disgorgement of \$272,600,000, prejudgment interest of \$17,529,196.86, and a civil penalty of \$68,000,000. *SEC v. Battoo*, No. 1:12-cv-7125, ECF No. 105. On September 6, 2012, the United States Commodity Futures Trading Commission (CFTC) also brought an action against Battoo and his companies. *CFTC v. Battoo*, No. 1:12-cv-7127 (N.D. Ill.). Pursuant to Commission Rule of Practice 323, I take official notice of the filings of *SEC v. Battoo* and *CFTC v. Battoo*. 17 C.F.R. § 201.323.

¹² I will collectively refer to Anchor Hedge Fund, FuturesOne, and PIWM, as the Battoo Funds.

bank account at EverBank owned and controlled by Anchor Holdings Florida. Tr. 224-26; *see* Resp. Ex. 95. Grossman established Anchor Holdings Florida to pool and wire clients' money to offshore investments after the U.S. government established strict anti-money laundering laws post-September 11, 2001. Tr. 753-55. Grossman was the signatory on the EverBank account and had the authority to obtain possession of any moneys that were in the account. Tr. 228. All the funds from Sovereign clients investing in Anchor Hedge Fund, FuturesOne, and PIWM were deposited and pooled into the same EverBank account until an investment was made on each client's behalf into a specific fund by wiring the moneys to the fund's offshore accounts; Sovereign clients were not made aware of the pooling of their funds. Tr. 66-67, 228-30, 887; Div. Ex. 50 at 5-6; Dp. 74; Dp. Ex. 21 at 3-4. The investments were made in the name of Anchor Holdings Nevis for the benefit of the individual client, not in the individual client's name. Tr. 230, 448-49.

Sovereign clients were never provided with a copy of the EverBank account statements; Grossman explained that he was not aware he was required to provide Sovereign's clients with a copy of these statements because the money was only in the account for a "very brief" time. Tr. 231, 755-56. Sovereign also was not subject to a surprise annual exam during Grossman's ownership. Tr. 201. When Sovereign clients wired their money to Anchor Holdings Florida, they believed they were sending their money directly to Anchor Hedge Fund. Div. Ex. 50 at 5; Tr. 66-67, 121-22. Grossman never told them he owned and controlled the EverBank account through Anchor Florida nor did he explain the flow of funds, unless asked. Tr. 67, 69, 71-72, 123-26, 756; Div. Ex. 50 at 5; Dp. Ex. 21 at 3-4. This practice contradicted information provided in the IAAs and Forms ADV from 2003-2008. The IAA stated that "Custody of Client's assets will be maintained with the independent custodian(s) mutually agreed upon by Client and Advisor. At no time will Advisor have custody of any of Client's assets." Div. Ex. 79 at 2; Div. Ex. 129 at 2; Resp. Ex. 1 at 2; Resp. Ex. 3 at 2. In Form ADV Part I Item 9, Sovereign answered "No" in response to inquiries regarding whether Sovereign or any related persons have custody of any advisory clients' cash, bank accounts, or securities. Div. Ex. 34 at 12; Div. Ex. 35 at 12; Div. Ex. 37 at 12; Div. Ex. 38 at 12; Div. Ex. 39 at 12; Div. Ex. 40 at 12; Div. Ex. 78 at 12; Div. Ex. 83 at 12. Grossman also repeated similar statements in communications with Sovereign clients. *See, e.g.*, Div. Ex. 64 at 1 ("I feel it is also important to point out the safety of your accounts Sovereign does not hold your assets and our client assets are typically held by one or more of the following entities, Penson Financial, Orange county Business Bank as IRA Custodian, EverBank or one the custodial banks for our alternative assets, EFG Bank. All of these entities are rock solid and accounts are structured in such a way that client's assets are not at risk.").

While he conducted his initial due diligence of the Battoo Funds, Grossman was not always provided with the name of the underlying funds in the Battoo Funds, or information regarding a fund's objective and its manager, though he believes he had conversations with Battoo regarding the composition of the funds. Tr. 672, 675-76. During his due diligence, Grossman never discovered that any of the underlying funds in Anchor Hedge Fund were linked to Madoff. Tr. 348. Grossman testified that up until a certain point, Battoo would sometimes periodically inform him of the underlying investments of Anchor Hedge Fund. Tr. 286. While Grossman was aware of Anchor Hedge Fund's underlying funds, he claimed he did not have access to information on the subfunds of the underlying funds. Tr. 349, 676. Grossman claimed

he was comfortable without knowing the subfunds of the underlying funds because it was normal for the hedge fund industry at the time. Tr. 676. After Battoo no longer updated him on the composition of Anchor Hedge Fund Class A (Anchor A), Grossman claimed that he continued to conduct due diligence by reviewing the PerTrac reports, hedge fund databases, updated hedge fund questionnaires, and the yearly financial statements. Tr. 678, 742.

Anchor Hedge Fund was incorporated in the British Virgin Islands on September 16, 2002.¹³ Div. Ex. 25 at 1; Div. Ex. 28 at 1; Resp. Ex. 25 at 1; Resp. Ex. 27 at 1.¹⁴ Sovereign clients were able to invest in subclasses A, B, C, E, and I. Tr. 216. Anchor Hedge Fund PPMs prohibited U.S. persons from purchasing Anchor Hedge Fund shares, unless they were considered a “Qualified Purchaser.”¹⁵ Div. Ex. 25 at 3; Div. Ex. 28 at 3; Resp. Ex. 25 at 2; Resp. Ex. 27 at 3. Grossman claimed that Sovereign’s clients were considered qualified purchasers, either because they met the definition of “accredited investor” in the Securities Act or because qualified purchasers include certain types of trusts, like IRAs, and qualified plans. Tr. 643-45, 811; Div. Ex. 50 at 4.

¹³ Anchor Hedge Fund Management Limited (Anchor Management) served as Anchor Hedge Fund’s Investment Manager. Div. Ex. 25 at 5, 12; Div. Ex. 28 at 5, 12; Resp. Ex. 25 at 5, 12; Resp. Ex. 27 at 5, 12. Battoo controlled Anchor Management; BC Hong Kong owned 65% of Anchor Management. Div. Ex. 19 at 6, 9-10, Ex. 7 at 3. Folio Administrators Limited (Folio Administrators) served as the Administrator, Share Registrar, and Transfer Agent to Anchor Hedge Fund. Div. Ex. 25 at 5, 15; Div. Ex. 28 at 5, 14; Resp. Ex. 27 at 5, 14. The corporate director of Folio Administrators, Folio Management Services Limited, later known as Fiduciary Group Limited, served as the Board of Directors of Anchor Hedge Fund. Div. Ex. 25 at 5, 15; Div. Ex. 28 at 5, 15; Resp. Ex. 27 at 5, 15. Daniel Cann (Cann), a Folio Administrators director, and Andrew F. Keuls (Keuls), an independent financial consultant, served on the Board of Directors of Anchor Management. Div. Ex. 25 at 5, 12-13; Div. Ex. 28 at 5, 12; Resp. Ex. 27 at 5, 12.

¹⁴ These documents use the term “Private Placement Memorandum” as well as “Prospectus.” For the purpose of this decision, I will use the term private placement memorandum (PPM).

¹⁵ Anchor Hedge Fund defined a Qualified Purchaser as follows:

- (i) Any subsidiary or affiliated entity of a bank, securities dealer or broker or other investment institution, which is neither incorporated in nor resident in the United States.
- (ii) Any “accredited investor” (as defined in the Rules made under the Securities Act, 1933 of the United States) who does not reside in the United States and who did not receive any offer to subscribe for shares (or any solicitation to receive any offer to subscribe for shares) in the United States.

Div. Ex. 25 at 3; Div. Ex. 28 at 3; Resp. Ex. 25 at 3; Resp. Ex. 27 at 3.

Grossman and Battoo were members of Anchor Hedge Fund's Investment Advisory Board, which assisted the Professional Advisory Board and acted as Anchor Hedge Fund's investment advisers.¹⁶ Div. Ex. 25 at 5, 13; Div. Ex. 28 at 5, 13-14; Resp. Ex. 25 at 5, 13-14; Resp. Ex. 27 at 5, 13-14. Upon investing in the various classes, all subscriptions were subject to a maximum 1%, later increased to 4.5%, cost of entry fee, to be deducted from the subscription amount and used for set-up and distribution costs. Div. Ex. 25 at 18; Div. Ex. 28 at 18; Resp. Ex. 25 at 18; Resp. Ex. 27 at 18.

Grossman testified he received and reviewed Anchor Hedge Fund's yearly consolidated financial statements for each particular share class. Tr. 300-01, 303-05; *see* Div. Exs. 87-88, 90. These statements generally arrived during the third quarter of the year. Div. Ex. 87 (audit letter dated September 21, 2007); Div. Ex. 88 (audit letter dated July 30, 2007); Div. Ex. 90 (audit letter dated September 15, 2008). Grossman did not find it unusual that the auditor would be auditing financial statements approximately nine months after the year ended. Tr. 310. The notes to the audited financial statements reveal that each class of Anchor Hedge Fund had cross liability to the other Anchor Hedge Fund classes, meaning that investments in one share class could be used to cover the liabilities of other share classes:

Although the assets, liabilities and equity of each class are kept separate and segregated from the general assets of the Fund, all of the assets of the Fund are available to meet all of the liabilities of the Fund, regardless of the class to which such assets or liabilities are attributable. In the case of insolvency of any class, all of the assets of the Fund attributable to other classes may be applied to cover the liabilities of the insolvent class.

Div. Ex. 87 at 7; Div. Ex. 88 at 7; *see* Div. Ex. 90 at 7; Resp. Ex. 33 at 10; Resp. Ex. 35 at 8; Resp. Ex. 41 at 8. There is no mention of cross-portfolio liability in the Anchor Hedge Fund PPMs. *See* Div. Ex. 25; Div. Ex. 28; Resp. Ex. 25; Resp. Ex. 27. Also in Anchor Hedge Fund's consolidated financial statements for the year ended December 31, 2007, was a disclosure that stated, "Subscriptions may be subject to a maximum of 4.5% sales commission for investors introduced to the Subfund by [Sovereign], a related party." Div. Ex. 90 at 13; Div. Ex. 91 at 13.

Anchor A was allegedly a market neutral hedge fund and its PPM represented that it involved "a medium degree of risk to capital." Tr. 219; Div. Ex. 28 at 1; Resp. Ex. 25 at 1; Resp. Ex. 27 at 1. The Anchor A PPM stated that Anchor A would invest in underlying funds that invested in "bank deposits, fixed income securities, spot and forward foreign exchange contracts, financial and commodity futures contracts, equities, exchange traded funds, options, derivatives, government and corporate debt and other financial instruments." Div. Ex. 28 at 4; Resp. Ex. 27 at 4. Anchor A funds were invested in Madoff feeder funds. Div. Ex. 94 at 2. Grossman could not recall when he initially learned about the underlying funds of Anchor A. Tr. 673. By December 2008, it had been "awhile" since Battoo provided Grossman with information about

¹⁶ Brian L. Kieran (Kieran), Julian R. Brown (Brown), Cann, and Keuls served on the Professional Advisory Board. Div. Ex. 25 at 5, 13-14; Div. Ex. 28 at 5, 13; Resp. Ex. 27 at 5, 13.

the underlying funds in Anchor A but Grossman was not concerned by this and did not view it as a cautionary red flag because he thought it was industry norm. Tr. 320, 323, 326, 342, 843.

Anchor Hedge Fund Class C (Anchor C) was a structured fund of hedge funds. Div. Ex. 25 at 1. The Anchor C PPM represented that Anchor C involved “a high degree of risk to capital.” *Id.* With respect to Anchor C, which invested in a structured note held at Societe Generale that was managed by several managers, Grossman telephoned Lyxor, the platform the note was on, to learn about the structured note, how it worked, and what it was comprised of. Tr. 278-80.

FuturesOne was a hedge fund incorporated in the British Virgin Islands on January 2, 2002.¹⁷ Div. Ex. 66 at 1; Div. Ex. 67 at 1; Resp. Ex. 54 at 1. The FuturesOne PPMs prohibited U.S. persons from purchasing FuturesOne shares, unless they were considered a “Qualified Purchaser.” Div. Ex. 66 at 3; Div. Ex. 67 at 3; Resp. Ex. 54 at 3. The FuturesOne definition of a Qualified Purchaser was the same as Anchor Hedge Fund. *Compare supra* note 15, with Div. Ex. 66 at 3, and Div. Ex. 67 at 3-4, and Resp. Ex. 54 at 3-4. All subscriptions were subject to a maximum 4.5% cost of entry fee, to be deducted from the subscription amount and made payable to the Fund toward expenses of set up and distribution costs. Div. Ex. 66 at 22; Div. Ex. 67 at 19; Resp. Ex. 54 at 19.

FuturesOne Class A (FuturesOne A) specialized in investing in a portfolio of commodity trading advisors (CTAs) managed accounts, market neutral hedge funds, and other alternative investment funds. Div. Ex. 66 at 1. The FuturesOne A PPM represented that FuturesOne A involved “a high degree of risk to capital.” *Id.* FuturesOne Class C (FuturesOne C) invested in a structured, custom-tailored alternative investment portfolio, utilizing only “best of breed” counter parties in the alternative investment universe. Div. Ex. 67 at 1; Resp. Ex. 54 at 1. The FuturesOne C PPM represented that FuturesOne C was associated with “a high degree of risk to capital.” Div. Ex. 67 at 4; Resp. Ex. 54 at 4.

PIWM was a managed account. Tr. 202-03. BC Hong Kong was the investment adviser to PIWM and Battoo was the manager. Tr. 204; Div. Ex. 21 at 4, 42; Div. Ex. 30, PIWM Description & Objectives at 10. PIWM’s management team and advisors included Battoo, Cann, Brown, Keuls, and Grossman.¹⁸ Div. Ex. 21 at 8; Div. Ex. 30. PIWM primarily invested in

¹⁷ Innovative Financial Holdings Ltd. (Innovative) served as the Investment Manager; Cann and Keuls were on the Board of Directors of Innovative. Div. Ex. 66 at 5, 13-14; Div. Ex. 67 at 5, 13; Resp. Ex. 54 at 5, 13. BC Capital owned 100% of Innovative. Div. Ex. 19 at 17. Folio Administrators served as the Administrator, Share Registrar, and Transfer Agent for FuturesOne. Div. Ex. 66 at 5, 17; Div. Ex. 67 at 5, 15; Resp. Ex. 54 at 5, 15. The corporate director of Folio Administrators, Fiduciary Group Limited, served as the Board of Directors of FuturesOne. Div. Ex. 67 at 5, 16; Resp. Ex. 54 at 5, 16. Kieran, Keuls, and Cann served on the Professional Advisory Board and Battoo served on the Investment Advisory Board. Div. Ex. 66 at 5, 14-15; Div. Ex. 67 at 5, 14-15; Resp. Ex. 54 at 5, 14-15.

¹⁸ Folio Administrators served as PIWM’s Administrator and provided “Independent Financial & Asset Verification Reports.” Div. Ex. 21 at 44. Alliance Investment Management Limited

Battoo-managed funds, including Anchor Hedge Fund and FuturesOne. Div. Ex. 69 at 11-12; Div. Ex. 70.

Referral Fees

In a January 17, 2003, email to clients, Sovereign announced that it had

taken an active role as an investment advisor to a British Virgin Islands based fund of hedge funds. This fund, available to accredited U.S. investors and foreign entities, mirrors our investment philosophy of active management over buy and hold. The strategy of this fund is to neutralize reliance on market direction, hence market neutral, to generate performance. It is structured to deliver conservative gains, month over month and year over year, not to hit the “homerun” with huge volatility swings. The underlying hedge funds that make up this fund are very well known and have been delivering positive performance for many years. I think it’s important to note that even though Sovereign is an investment advisor to this fund, we have no additional compensation for recommending it. Our independence is paramount to our firm and our clients and we would never compromise this. We would only recommend the fund for clients where the strategy makes sense, just like every other investment we make available.

Div. Ex. 23 at 3-4.

In 2003, Grossman and SIAM LLC entered into several written agreements for compensation for referrals. For example, SIAM LLC entered into a referral agreement with Anchor Hedge Fund on August 1, 2003, whereby SIAM LLC would receive 1% of the sales load for SIAM LLC customers referred to Anchor A and Anchor B, and 2% sales load for SIAM LLC customers referred to Anchor E and Anchor I.¹⁹ See Div. Ex. 71 at 6; Tr. 356. On September 1, 2003, SIAM LLC entered into a referral agreement with FuturesOne. See Div. Ex. 72. According to the agreement, SIAM LLC, would receive 2% sales load for SIAM LLC customers that SIAM LLC referred to FuturesOne A and FuturesOne B and 50% of the investment manager fees for investors that SIAM LLC referred. *Id.* at 6; Tr. 360. On November 1, 2003, SIAM LLC entered into a referral agreement with BC Panama. See Div. Ex. 73. According to the agreement, SIAM LLC would receive 50% of the 1-2% investment manager/advisor fees for customers that SIAM LLC referred to PIWM. *Id.* at 6; Tr. 364.

In addition to these written agreements, there was also an oral agreement pursuant to which SIAM LLC was paid the 4.5% cost of entry fee that Sovereign investors paid when investing in Anchor Hedge Fund. Tr. 371-72. This 4.5% fee was not in addition, but an increase, to the 1-2% sales load from the initial written referral agreement. Tr. 373.

(Alliance Investment), Brown’s employer, served as the bank custodian and financial administrator for PIWM. Tr. 212; Div. Ex. 21 at 6, 43; Resp. Ex. 62 at 3.

¹⁹ The sales load is a fee that an investor pays upon investing in the fund; this fee comes out of the investment itself. Tr. 356-57.

The referral fees SIAM LLC received from Anchor Hedge Fund, FuturesOne, and BC Panama were paid into SIAM LLC's bank account at Jyske Bank in Denmark, an account set up as the only recipient of compensation from the referral fees. Tr. 358, 362-63, 366, 373-77. In exchange for these referrals, Grossman received more than \$3.4 million in compensation from Battoo. *See* Div. Ex. 75; Div. Ex. 149.

Grossman testified that investor funds falling under the scope of referral agreements were not subject to additional fees charged by Sovereign, and that he informed clients about the referral fee arrangements orally in telephone conversations, in email, and in numerous documents, including the IAA, Sovereign's Form ADV Part II, the various fund PPMs, and the fund subscription agreements, although he did not disclose that the fees were paid to SIAM LLC, specifically. Tr. 358, 365, 384-87, 389-90, 725-27.

International Consultant Agreement

On December 1, 2003, Grossman entered into an agreement with Anchor Management and became International Consultant to Anchor Hedge Fund to "generally advise the manager in the strategic implementation of the objectives of the Fund."²⁰ Div. Ex. 74 at 2. The fund's objectives were to obtain new investors and to make the fund available to whoever wanted to invest, as long as they met certain requirements. Tr. 886. Grossman's duties were:

- (a) continuous analysis of the performance of all investments which are for the time being and from time to time represented in the portfolio of the Fund and the provision of monthly (or more frequently if the Manager shall so reasonably require) reports in writing thereon;
- (b) recommendations on the manner in which money required for any redemptions of shares in the Fund should be realized;
- (c) advice concerning the appropriate action or actions which the International Consultant considers that the Manager should take in order to carry into effect the Fund's objectives;
- (d) preparation of material for inclusion in the monthly or other reports of the Fund whenever such material shall be required; and
- (e) preparation (and if requested, joint presentation with the Manager) of reports to the directors of the Fund.

²⁰ When asked how he could fulfill his role as consultant for Anchor Hedge Fund without knowing all the details of the underlying funds, Grossman explained that he was consulting on how IRAs and other qualified retirement plans could invest in Anchor Hedge Fund; he was not advising Anchor Hedge Fund on its underlying investments. Tr. 844.

Div. Ex. 74 at 3; *see* Tr. 738. Grossman testified that he only provided the duties listed in subpart (c) and he examined a potential investor's retirement plan to determine whether investing in Anchor Hedge Fund would be an allowed or prohibited investment. Tr. 739, 883, 885-86.

Under the agreement, Grossman was to be paid a quarterly advisory fee equal to 50% of the 1% annual management fee for Anchor Hedge Fund and a performance fee of 50% of 10% of new net profits. Div. Ex. 74 at 4; Tr. 368-69. Grossman explained that the management fee was charged to Sovereign clients who were invested in Anchor Hedge Fund. Tr. 369. According to Grossman, the performance fee worked as follows: if an account appreciated 1% in one quarter, then Grossman would have received half of 10% of that, or about .05%. Tr. 369-70. All of these fees were paid into the Jyske Bank account. Tr. 371, 737.

Grossman was listed as Investment Adviser, member of the Investment Advisory Board, and Investment Consultant to Anchor Hedge Fund. Tr. 251; Div. Ex. 25 at 5, 13; Div. Ex. 28 at 5, 13; Div. Ex. 29 at 5, 13; Div. Ex. 30 at 5, 8; Div. Ex. 31 at 5, 8; Div. Ex. 32 at 5, 9, 28; Div. Ex. 33 at 5, 9; Div. Ex. 50F at 5, 9, 28; Div. Ex. 74; Resp. Ex. 25 at 5, 13; Resp. Ex. 27 at 5, 13; Resp. Ex. 29 at 5, 13; Resp. Ex. 90 at 2. At some point, Grossman sent Anchor Hedge Fund a letter explaining that "Investment Advisor" was not an accurate portrayal of his role and that he was really acting as an international consultant in determining when an IRA or qualified plan could make investments into Anchor Hedge Fund. Tr. 251-58. Cann, Director of Fiduciary Group, in letters dated July 1, 2008, and July 8, 2009, confirmed that Grossman "acts as an International Consultant" for Anchor Hedge Fund and that in the intervening time between the two letters, Grossman did not "give[] any direct investment advice or analysis in [his] role as International Consultant." Resp. Ex. 13; Resp. Ex. 14.

Jyske Bank account records

SIAM LLC held two accounts at Jyske Bank, one in Euros and one in U.S. Dollars. Tr. 610. Kathleen Strandell (Strandell), a staff accountant at the Commission's Miami regional office, examined the bank statements in both accounts from 2004 through October 10, 2008, and calculated by year the deposited funds received from Anchor Hedge Fund, Folio Administrators, FuturesOne Diversified, and Alliance Investment. Tr. 606, 609-13; Div. Ex. 153; Div. Ex. 154. For the U.S. Dollar account, SIAM LLC received the following referral and consulting fees broken down by year:

2004	\$236,036
2005	\$331,152
2006	\$612,776
2007	\$1,172,401
2008	\$521,228

Div. Ex. 153; *see* Tr. 358, 362-63, 366, 371, 373-74, 376-77, 737; Div. Exs. 75, 149. For the Euro account, SIAM LLC received the following referral and consulting fees, broken down by year and converted into U.S. Dollars²¹:

2004	\$53,350.881
2005	\$43,456.285
2006	\$110,102.957
2007	\$262,098.845
2008	\$60,163.688

Div. Ex. 154; *see* Tr. 358, 362-63, 366, 371, 373-74, 376-77, 737; Div. Exs. 75, 149.

The total of the two accounts is \$3,407,765.66.²² Tr. 617.

Disclosure

Most, but not all, Sovereign clients signed an IAA. *See* Tr. 34-36, 108-09; Div. Ex. 50 at 1-2; Div. Ex. 50E; Resp. Ex. 103; Resp. Ex. 107; Dp. Exs. 12-13; Dp. Ex. 21 at 4. Sovereign's IAA in effect up until at least February 2005 stated that the "Advisor will not be compensated upon the basis of a share of capital gains, or capital appreciation of any of the portfolio assets." *See* Div. Ex. 129 at 2; Resp. Ex. 1 at 2; Tr. 654-58. This IAA did not disclose any referral or international consultant agreements by Grossman or Sovereign or that Grossman or Sovereign were receiving compensation for investment referrals. *See* Div. Ex. 129; Resp. Ex. 1.

In Sovereign's Form ADV Part I, dated February 12, 2004, Item 5.E asks advisers to provide all means in which they are compensated for their investment advisory services. Div. Ex. 83 at 8. In response, Sovereign indicated a percentage of assets under management and hourly charges. *Id.* Sovereign did not disclose any fees and compensation paid to SIAM LLC and Grossman. *See* *Id.* Sovereign represented in Item 6.B(1) that it was not actively engaged in any other business other than giving investment advice to clients; in Item 6.B(3) that it did not sell products or provide services other than investment advice to its advisory clients; and in Item 9 that neither Sovereign nor any related person had custody of its advisory clients' cash or securities. *Id.* at 9, 12.

²¹ Strandell converted the Euros into U.S. Dollars using Bloomberg's average U.S. Dollar and Euro rates for each year. Tr. 611-14. She used the average conversion rate for each year to capture any fluctuations in the U.S. Dollar versus the Euro because that is the typical accounting practice when moneys are deposited at different times throughout the year. Tr. 614.

²² The totals in the charts actually add up to \$3,402,765.66, a difference of \$5,000 from Strandell's testimony. This discrepancy appears to be an error in the 2008 column of funds received from Alliance Investment in the U.S. Dollar account; the chart lists \$231,246, while the amount received during this period according to the bank statements is \$236,246. Div. Ex. 75 at Statement Nos. 40-41; Div. Ex. 153.

Also, Sovereign's Form ADV Part II did not disclose the fees and compensation paid to SIAM LLC and Grossman under the referral or international consultant agreements. *See* Div. Ex. 131. In Item 8, Sovereign represented that it did not have an arrangement with an investment company that was material to its advisory business or its clients.²³ In Item 9, Sovereign represented that it did not recommend to clients that they buy or sell securities or investment products in which Sovereign or a related person had some financial interest. Div. Ex. 131 at 5. In Item 13, Sovereign represented that neither it nor a related person had any written or oral arrangements where it received additional compensation. Div. Ex. 131 at 6. Finally, on Schedule F, Sovereign did not disclose the fees and compensation paid to SIAM LLC under the referral and international consultant agreements. Div. Ex. 131 at Schedule F.

Commission's Office of Compliance Inspections and Examinations (OCIE) 2004-2005 Examination

Jesse Alvarez (Alvarez) and Tonya Tullis (Tullis) conducted an OCIE examination of the books and records of Sovereign pursuant to Section 204 of the Advisers Act at the end of 2004. It took Alvarez and Tullis about two weeks to complete the field work phase of the examination. Tr. 699, 936. Alvarez interviewed Grossman but no other employees because Sovereign was a small operation and Grossman was the primary individual responsible for all the registrant's activities. Tr. 937.

OCIE sent Sovereign a deficiency letter dated February 7, 2005, as a result of the examination. *See* Div. Ex. 141. The deficiency letter noted eleven areas of concern. *See Id.* at 1, 4. OCIE found that the IAA may be misleading and stated that Sovereign should either comply with the IAA, or amend the IAA to disclose the receipt of performance based compensation. *Id.* at 1; Tr. 939. OCIE also noted that Sovereign "may also need to amend its ADV Part II to disclose the receipt of performance based compensation." Div. Ex. 141 at 1. Alvarez explained that this sentence depended on the action Sovereign intended to take with respect to the IAA, i.e., if Sovereign decided to amend the IAA, then it would also have to amend the Form ADV Part II. Tr. 939-40.

The February 7, 2005, deficiency letter noted three Form ADV inaccuracies regarding Grossman and Sovereign's relationship with the Battoo Funds.²⁴ *See* Div. Ex. 141 at 4. The deficiency letter provides first, that in Part 1A, Item 8.B(2), Sovereign should indicate "Yes" in response to whether Sovereign or any related person recommends the purchase of securities to advisory clients for which Sovereign or any related person serves as underwriter, general or managing partner, or purchaser representative. *Id.* Second, in Part 1A Item 8.B(3), Sovereign should indicate "Yes" in response to whether Sovereign or any related person recommends the purchase or sale of securities to advisory clients for which Sovereign or any related person has

²³ Citations for Division Exhibit 131 are to the page number listed on the top left corner of the document.

²⁴ Grossman testified that he submitted the due diligence he had done on Battoo's funds to OCIE. Tr. 665; *see* Resp. Ex. 90.

any other sales interest, meaning the various compensation arrangements with offshore money managers and hedge funds. *Id.* Third, in Part II Item 1D, Sovereign should disclose the fees, such as the performance and advisory fees, received from offshore hedge funds on Schedule F. *Id.*

Grossman responded to the deficiency letter on March 8, 2005, and represented that Sovereign's IAA and Form ADV were modified to more accurately reflect the various ways that Sovereign may receive compensation, and that Sovereign made all of the corrections indicated by OCIE. *See* Div. Ex. 142 at 2-3.

After the 2004-2005 OCIE Examination

Sovereign's IAA, revised in August 2006, included a disclosure that "The Advisor *may* receive performance-based compensation from certain investment companies. Advisor will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Advisor." Div. Ex. 79 at 2 (emphasis added); Resp. Ex. 3 at 2; Tr. 731. The revised IAA continued to state that Sovereign would not be compensated upon the basis of a share of capital gains or capital appreciation of any of the portfolio assets. Div. Ex. 79 at 2; Resp. Ex. 3 at 2.

Grossman revised Sovereign's Form ADV Part I as suggested by OCIE and as Grossman represented in his response to OCIE. *See* Div. Exs. 34-35, 37-40, 78, 141-42. Grossman explained the following fixes to the Form ADV Part II:

- Item I.C provides a number of choices in response to "Applicant offers investment advisory services for." According to Grossman, by checking the box next to subscription fees, Sovereign was disclosing to clients what the different Battoo Funds were paying him. Tr. 722-23; Div. Ex. 36 at 2; Div. Ex. 50B at 2; Div. Ex. 50C at 2; Div. Ex. 77 at 2; Resp. Ex. 110 at 2.²⁵
- In Schedule F, the fees that Sovereign would receive were disclosed as follows: "[Sovereign] may receive incentive or subscription fees from certain investment companies. [Sovereign] may receive performance-based compensation from certain investment companies. [Sovereign] will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to [Sovereign]." Tr. 724-25, 727; Div. Ex. 36 at 69817; Div. Ex. 40-1 at Schedule F; Div. Ex. 50B at Schedule F; Div. Ex. 50C at Schedule F; Div. Ex. 77 at Schedule F; Resp. Ex. 110 at Schedule F.²⁶

²⁵ Sovereign's Form ADV Part II dated March 26, 2008, does not have the subscription fee box checked in Item I.C. Div. Ex. 34-1 at 2; Div. Ex. 40-1 at 2; Div. Ex. 41 at 2.

²⁶ Sovereign's Form ADV Part II dated March 26, 2008, omits this first sentence. Div. Ex. 34-1 at Schedule F; Div. Ex. 41 at Schedule F.

Grossman chose to use the word “may” as part of his disclosure statement because he took that language from the OCIE examination deficiency letter, which stated that “[Sovereign] may also need to amend its ADV Part II” Tr. 856-57. He believes that “may” is accurate and not misleading because Sovereign did not always receive compensation and whether Sovereign received these fees depended on the client. Tr. 859.

Grossman did not properly revise Sovereign’s responses in Form ADV Part I Item 5.E, Item 6.B(1), Item 6.B(3), or Item 9 to disclose that SIAM LLC received fees and compensation as a result of the referral and international consultant agreement, Sovereign was actively engaged in any business other than giving investment advice to clients, Sovereign did sell products or provide services other than investment advice, and Sovereign did have a related person that had custody of its clients’ cash or securities. Div. Ex. 34 at 8, 12; Div. Ex. 35 at 8-9, 12; Div. Ex. 37 at 8-9, 12; Div. Ex. 38 at 8-9, 12; Div. Ex. 39 at 8, 12; Div. Ex. 40 at 8, 12; Div. Ex. 78 at 8-9, 12; *see supra* p. 17.²⁷ For ADV Part II, Grossman did not revise the misleading responses in Item 8, Item 9, and Item 13. Div. Ex. 34-1 at 4-6; Div. Ex. 36 at 4-6; Div. Ex. 40-1 at 4-6; Div. Ex. 41 at 4-6; Div. Ex. 77 at 4-6; Resp. Ex. 110 at 4-6; *see supra* p. 18.

Problems with Anchor A

Grossman testified that he first learned that the underlying funds of Anchor A were invested in the Madoff Ponzi scheme in December 2008. Tr. 313-14, 693. On December 22, 2008, and again on December 23, Folio Administrators sent Sovereign a letter regarding the suspension of the determination of net asset value and redemptions of Anchor A. Div. Ex. 94; Resp. Ex. 23. The letter states that the determination of net asset value and redemption of shares would be suspended because Anchor A “invests substantially all its assets in underlying funds . . . which implement their Fund’s strategies through Bernard L. Madoff Investment Securities LLC” and “that in view of the potential losses . . . the investments owned by the Fund cannot reasonably be promptly and accurately ascertained.” Div. Ex. 94 at 2; Resp. Ex. 23 at 1; Tr. 313.

In February 2009, Grossman, under the title of Managing Director, and Adams notified Anchor A’s investors that Anchor A “was invested in a number of other hedge funds all of which had exposure to Madoff” and had subsequently suspended the calculation of net asset value and redemption requests. Div. Ex. 50P at 1. One investor asked how substantially all of the underlying funds could have been investing with Madoff when Grossman initially assured him that Anchor A was diversified and involved with a number of unrelated managers. Div. Ex. 50 at 3, 6. Grossman told that investor that Anchor A had eight underlying managers and he had not

²⁷ Sovereign’s Forms ADV Part I dated March 29, 2007, March 26, 2008, and May 29, 2008, disclosed that Sovereign was actively engaged in any business other than giving investment advice to clients and that it sold products or provided services other than investment advice to its advisory clients. Div. Ex. 34 at 9; Div. Ex. 39 at 9; Div. Ex. 40 at 9. The ADV does not further describe this other business, product, or service.

been aware that all of them had invested exclusively with Madoff.²⁸ *Id.* at 6. As of October 2013, Sovereign's clients have not recovered their Anchor A funds. Div. Ex. 50 at 7.

Problems with Anchor C

On October 13, 2008, Anchor Management sent a letter to shareholders suspending the redemption of Anchor C so the fund could switch its portfolio from one bank to another. Div. Ex. 98 at 7657. The letter explained that this process had originally begun in the fourth quarter of 2007, but had been delayed due to "deteriorating financial market conditions." *Id.* Grossman did not recall being made aware of this decision to switch banks in 2007. Tr. 328.

Sovereign did not immediately notify its clients about the suspension of redemptions and, in fact, advised its clients to "stay the course." Div. Ex. 64 at 1; *see* Div. Ex. 151 at 7-8. In his October 14, 2008, email introducing Adams to Sovereign clients, Grossman wrote regarding "these trying times in the global markets," reassuring investors that while the funds may have experienced a "rough" September, they "will experience an incredible bounce, should October continue its dramatic recovery. Patience will be rewarded." Div. Ex. 64 at 1.

In mid-November 2008, Sovereign notified its clients that Anchor C redemptions were suspended. *See* Div. Ex. 151 at 7-8. In late November 2008, Battoo proposed, and Sovereign strongly recommended that Sovereign clients accept, a swap of their Anchor C shares for PIWM shares. Tr. 145; Div. Ex. 50 at 7; Div. Ex. 151 at 7. As part of the swap deal, Sovereign clients had to agree to an eighteen-month lockup period. Tr. 136; Div. Ex. 50 at 8; Div. Ex. 151 at 7; Dp. 107; Dp. Ex. 21 at 6-8. Sovereign provided minimal background material on PIWM and a limited period of time to decide whether to participate in the swap.²⁹ Tr. 145; Div. Ex. 50 at 8; Div. Ex. 50T; Div. Ex. 50U; Div. Ex. 151 at 7; Dp. 98; Dp. Ex. 15. Sovereign clients believed that if they did not accept this swap, their Anchor C and FuturesOne C investments would become illiquid and unredeemable. Tr. 136-37; Div. Ex. 50 at 9; Dp. 99-100.

According to the Division, Grossman may have provided investment advice to Sovereign clients regarding the PIWM swap. *See* Div. Ex. 113 at 9741; Div. Ex. 113-1 at 14587. Grossman signed two letters on Sovereign letterhead, dated November 21, 2008, and addressed to two Sovereign investors, stating

²⁸ Grossman testified that he hired an attorney and tried to file claims with Irving Picard (Picard), the trustee appointed to liquidate Madoff securities, as did some individual Sovereign investors. Tr. 760; Div. Ex. 50R; Div. Ex. 50 at 6-7; Div. Ex. 50Q. They were informed their claims would have to be handled by the fund they invested in. Div. Ex. 95 at 1931, 1952; Div. Ex. 50R; Div. Ex. 50S at 1-2; *see* Div. Ex. 50 at 6-7. Battoo has not provided information on the feeder funds, nor were any claims filed on behalf of the underlying feeder funds. Div. Ex. 50S at 2.

²⁹ Investors who owned shares of FuturesOne C were also offered this swap deal, though they were not informed as to why these shares were part of the transfer. Div. Ex. 50 at 8; Div. Ex. 50V.

Thank you for the opportunity to work together with you in developing a strategy to achieve your financial goals. Based on our conversation and detailed analysis, please review the summary of the portfolio allocation to be implemented on your behalf. If you would like to further discuss these investments, please contact me as soon as possible.

Div. Ex. 113 at 9741; Div. Ex. 113-1 at 14587.

Jessina Paturzo (Paturzo), a current employee of SIPS, testified that she had mistakenly sent these two letters.³⁰ Tr. 574, 578, 593-94, 596. Rich Luchsinger (Luchsinger), a Sovereign employee, asked Paturzo to send the PIWM swap paperwork to two investors because Sovereign was shorthanded and had a lot of paperwork to complete.³¹ Tr. 575-577, 594. Paturzo testified that she mistakenly sent out a different document than the one requested by Luchsinger and the correct form was Respondent Exhibit 133. Tr. 594; 597-99; compare Div. Ex. 113 and Div. Ex. 113-1 with Div. Ex. 50U and Resp. Ex. 133. Adams confirmed that the documents in Division Exhibits 113 and 113-1 would not have been used in the Anchor C swap. Tr. 509-10, 514.

The PIWM swap did not resolve the problems with Anchor C, and Sovereign clients invested in Anchor C have not recovered their investments. Tr. 165, 527; Dp. 111.

Investor witnesses

The Division presented testimony from several public witnesses.

James W. Davidson (Davidson) is a retired CPA living in Ecuador since 2007.³² Div. 50 at 1. Davidson met Grossman at a conference in Panama in 2006. *Id.* Davidson opened an account with Sovereign in 2006, based on Grossman's representation that as a registered investment adviser Sovereign offered "highly personalized and individually tailored solutions." *Id.* Davidson had to request an ADV Part II from Sovereign, which was dated March 28, 2006. *Id.* The only other Form ADV Part II he received was dated August 22, 2006. *Id.*

In November 2006, Davidson invested in Anchor A, Anchor C, and FuturesOne C shares based on Grossman's representations that Anchor A used multiple managers and was the type of

³⁰ Paturzo testified that she joined Sovereign in February 2008, and joined SIPS when Grossman sold the business, and considered herself "fairly new" to the company in November 2008. Tr. 574-77, 581. At Sovereign, most of Paturzo's work related to IRA transfers, not dealing with the investment side of the business. Tr. 600.

³¹ Paturzo's testimony is supported by investor Carmen Montes. Montes received the letter marked as Division Exhibit 113-1 after she spoke about the PIWM swap with Luchsinger. Tr. 145-46.

³² Davidson did not testify at the hearing because he resides outside the United States. I admitted Division Exhibit 50 and Division Exhibits 50A through 50AA pursuant to Commission Rule of Practice 235. Tr. 17-18. Grossman did not object. Tr. 18.

fund suitable for widows and orphans, and Davidson's money would be safe. *Id.* at 3-4. Grossman provided Davidson with an Anchor Presentation dated August 2006; he never provided Davidson with a PPM for any class of Anchor funds. *Id.* at 2, 4; Div. Ex. 50F. On the applications for Anchor A, Anchor C, and FuturesOne C shares, Grossman instructed Davidson to cross out the acknowledgement of U.S. citizenship and substitute "Qualified IRA." Div. Ex. 50 at 5. According to Sovereign statements, Davidson had a total of \$1.3 million in the three funds as of September 30, 2008. Div. Ex. 50Z.

Davidson only agreed to pay Sovereign a management fee. Div. Ex. 50 at 2. Davidson considers Sovereign or Grossman's receipt of compensation from funds Grossman advised him to invest in a serious conflict of interest and would not have invested with Sovereign and Grossman if he had been told this information. *Id.* Grossman never told Davidson that he invested his money through Anchor Holdings or that his investments were not held in the name of his IRA account. *Id.* at 5.

In early February 2009, Davidson received a letter from Grossman and Adams notifying him of the suspension of redemptions of Anchor A because the underlying funds had invested "substantially all" of their funds with Madoff. Div. Ex. 50 at 6; Div. Ex. 50P. Davidson spoke with Grossman by telephone, asking how this could have occurred, especially when Grossman was his adviser and an adviser to Anchor Hedge Fund and he knew that Davidson wanted diversification in his investments. Div. Ex. 50 at 6. Grossman told him that he had not been aware that all eight managers had invested exclusively with Madoff. *Id.*

Davidson submitted a claim in the amount of \$699,365.57 with Picard, the Madoff trustee. *Id.* at 6; Div. Ex. 50Q. Davidson received a notice from Sovereign stating that Anchor A had filed a claim with Picard but Picard had not yet received a claim from one of the underlying funds and incorrectly believed that Anchor A's claims could not be processed until the underlying fund filed a claim. Div. Ex. 50 at 6-7; Div. Ex. 50R. On July 15, 2009, Davidson received an email from Grossman and Adams stating that the underlying fund's office had closed. Div. Ex. 50 at 7; Div. Ex. 50S. Davidson is not aware of the status of his claim; Grossman told him that the question of whether investors in feeder funds had standing to file a claim would have to be litigated. Div. Ex. 50 at 7.

On Adams's recommendation, Davidson agreed to swap his shares of Anchor C and FuturesOne C for PIWM; this investment was worth almost \$800,000. *Id.* at 7-9. As of October 11, 2013, Davidson has been unable to redeem his interests in PIWM. *Id.* at 10.

Carmen Evarista Montes-Perkins (Montes), a resident of California, has been retired since 2005. Tr. 100-01. Montes was not an experienced investor and did not know what a PPM or Form ADV was. Tr. 113, 127. On August 14, 2007, Montes signed an IAA with Sovereign. Resp. Ex. 107. On October 25, 2007, Montes signed a subscription agreement to invest her IRA funds of \$109,600 with Sovereign. Resp. Ex. 108. Montes read the information Sovereign provided and she thought it said that Anchor C was low risk; Luchsinger, Sovereign's Associate

Director, advised her that it was a safe, low-risk investment.³³ Tr. 106, 108, 119, 152, 154; Resp. Ex. 107. Montes signed the form but someone at Sovereign filled it out. Tr. 116. It appears that at the same time, Montes signed a form making SIPS the administrator of her pension. Tr. 147-48. The IAA includes a clause stating that Montes acknowledges receipt of Sovereign's Form ADV Part II. Tr. 149-50.

Montes considered Grossman to be her investment advisor because Sovereign brochures contained his name and highlighted his experience, Luchsinger worked for him, Grossman signed the IAA, and he was copied on emails that Montes received from Luchsinger. Tr. 104, 108-09, 123. Montes did not speak to Grossman, but received emails from him. Tr. 130-31. One email dated September 5, 2008, stated that Anchor Hedge Funds had provided superior returns over the past ten years compared to other asset class and that Anchor C was down 5.5% that year. Div. Ex. 151 at 1-2.

Montes was only aware that she would be charged a 1% annual management fee based on the value of the assets invested; Montes did not know that she was being charged any other fees. Tr. 110-13. Montes's IAA form has a yes next to "Initial Form of 4.50 percent to be deducted," but she did not understand what it was for. Tr. 119-20.

Montes never saw any referral or consulting agreements signed by Grossman and Anchor Hedge Fund and she was never told that Grossman had a consulting contract with Anchor Management under which he received a percentage of Anchor C's management fee and performance fees equal to a percentage of new profits. Tr. 123-24.

Montes believed that she was investing in an account in her name in Anchor C; she did not know that Sovereign pooled her investment. Tr. 125-26. When she asked Sovereign for her account, Sovereign told her they would fill it in on the form. Tr. 126-27. Montes received quarterly statements from Pension Resource Services, a company out of Texas, not from Sovereign. Tr. 127.

In an email dated October 14, 2008, Grossman announced that Adams had been named Sovereign's President and Chief Investment Officer, and that he would continue to advise Adams and remain Managing Director of SIPS. Tr. 134-35; Div. Ex. 151 at 3-4. Montes continued to believe that Grossman was still the owner, in charge of Sovereign, and her investment adviser. Tr. 135, 140-41, 164-65. Montes tried to call Grossman, Adams, and Luchsinger, in October 2008, but they were always unavailable. Tr. 138-39.

Montes requested a redemption form for her Anchor C account on October 8, 2008, but Adams notified her on November 18, 2008, that the investment manager for Anchor C had suspended redemptions. Tr. 137, 164; Div. Ex. 151 at 5-8. The email from Adams offered a choice of either waiting for Anchor C redemptions or swapping Anchor C shares "for PIWM Market Neutral, which frankly has had much better performance." Div. Ex. 151 at 7. On

³³ At Sovereign's instructions, Montes transferred her funds to the Anchor Florida account at EverBank. Tr. 117-18. She thought that Anchor Florida was owned by Anchor Hedge Fund. Tr. 121. She did not know it was owned by Grossman. Tr. 123.

November 22, 2008, Montes chose the swap because she wanted her money back as soon as possible. Tr. 136-37, 145-46; Div. Ex. 113-1; Div. Ex. 151 at 12-14. On January 15, 2009, Adams notified Montes that Grossman had rejoined Sovereign as managing director. Div. Ex. 151 at 11.

In early 2009 or 2010, Orange County Business Bank notified Montes that it was no longer custodian of her account and Grossman told her he no longer owned Sovereign and he was “just in charge of the administrative portion of [her] pension.” Tr. 140-43. Montes paid Grossman \$500 when he found a new custodian bank, and a few months later Grossman requested another \$500 claiming he paid the custodian a year in advance. Tr. 143. When Montes refused, Grossman said she could face income tax consequences. Tr. 143-44.

Montes has not been able to recover any of the retirement funds she invested in Anchor C. Tr. 165. She is not sure if the total amount she invested was \$109,600 or \$112,000. Tr. 165; Resp. Ex. 108.

Stephen Richards (Richards), a retired attorney who had been employed as a Vice President at a major transportation company, resides in Washington State.³⁴ Dp. 8. Richards, an accredited investor, met Grossman in 2007. Dp. 9; Dp. Ex. 3. Richards trusted Grossman because Grossman was very convincing that he was an honest, talented person and because Agora Financial chose him as a speaker. Dp. 66, 185-86; Dp. Ex. 21. Richards had no experience in alternative investments; he was investing retirement funds and the client profile he submitted to Sovereign listed his number one investment objective as long term growth and appreciation. Dp. 21-22; Dp. Ex. 3.

At Grossman’s recommendation, Richards agreed on December 11, 2007, that 70% of his investment with Sovereign would go into Anchor A and Anchor C, diversified investments. Dp. 58-59, 226; Dp. Ex. 5. Richards received a PPM for both funds. Dp. 184. Richards understood that Anchor A involved a medium degree of risk to capital and that it “was investing into a portfolio of well-established and independently administered and audited hedge funds.” Dp. 44-45; Dp. Ex. 7. Grossman told Richards that Anchor A was a fund of funds and thus a safer investment. Dp. 182-83. The PPM for Anchor C stated that it involved a high degree of risk, but that is not what Grossman told Richards. Dp. 209.

Sovereign did not inform Richards that Anchor C was in serious financial trouble in the fourth quarter of 2007. Dp. 88-89, 197; Dp. Ex. 14. Richards communicated with both Grossman and Adams. Tr. 90-91.

In addition, Richards did not know in December 2007 that Grossman received the 4.5% fee, which he thought the two hedge funds used for set up and distribution expenses. Dp. 42, 48-

³⁴ Richards was unable to testify at the hearing. Dp. 116. The transcript and video of Richards’s deposition were allowed in evidence pursuant to 17 C.F.R. § 201.233. *Larry C. Grossman*, Admin. Proc. Rulings Release No. 1207, 2014 SEC LEXIS 342 (Jan. 29, 2014). I will cite to the transcript of the deposition as “Dp. ___” and deposition exhibits as “Dp. Ex. ___.”

49, 61-62; Dp. Ex. 21. Grossman did not tell Richards that Grossman was on the Board of Anchor Hedge Fund, that he received fees and compensation from Anchor Hedge Fund based on Richards's investments, that he had written agreements with Anchor Hedge Fund that provided for fees and compensation to Sovereign, or that he had a consulting agreement with Anchor Management by which Grossman received a portion of the management fee. Dp. 43, 55, 75-76, 79-82.³⁵ According to a sworn Declaration dated February 29, 2012, Grossman did not make Richards aware "of any compensation agreements arrangements between [Sovereign], Grossman or their affiliates and Nikolai Battoo ("Battoo"), the investment adviser and manager of Anchor, [Anchor A or Anchor C] or their affiliates." Dp. Ex. 21. Richards checked a box on the form indicating non-citizenship because Grossman told him that the IRA was not a United States citizen. Dp. 63, 190. Grossman did not mention Battoo when he encouraged Richards to invest with Sovereign. Dp. 46-47.

Richards believed he became a Sovereign customer in early 2008 when he transferred his IRA account into Sovereign. Dp. 64, 84. A Report of Cash Account for Richards Traditional IRA Self Directed for 10/01/2007 to 12/31/2007 prepared by Pension Resources Corp., shows there was an IRA cash transfer into the account on December 27, 2007, with a wire received from TD Ameritrade in the amount of \$243,272.03. Dp. Ex. 9; Dp. Ex. 21. On April 1, 2008, Sovereign sent Richards a Portfolio Statement Estimate as of February 29, 2008, that shows Richards with \$161,777 evenly divided between Anchor A and Anchor C. A financial statement that Richards believes came from SIPS showed that as of March 31, 2008, Richards had \$73,858.95 in Pension Financial Services, Inc., and \$169,400 in Anchor Holdings. Dp. 71; Dp. Ex. 11.

Richards requested to redeem his investments in Anchor A and Anchor C on November 4, 2008. Dp. 36, 93, 103-04; Dp. Ex. 21. He would never have invested with Sovereign, if he had known Grossman was going to sell the company. Tr. 93-94; Dp. Ex. 21.

Richards intended that his Sovereign investments would be in his name for benefit of his IRA, but he later learned that his funds were pooled in Anchor Florida, a limited liability company owned by Grossman, and transferred in an elaborate arrangement, involving Grossman that Richards could never understand. Dp. 72-74; Dp. Ex. 21. Grossman never provided Richards with information that he promised about funds that held Richards's IRA funds. Dp. 74. According to Richards, Anchor Nevis was the subscriber of his investment in Anchor A and Anchor C. Dp. Ex. 21.

Initially Grossman told Richards that he was an investment adviser to the funds, but in 2008, Richards learned that Grossman was taking a different position. Dp. 51, 206. In addition to the fees that he agreed to pay Sovereign, Richards later learned that Grossman and a manager of his IRA were basically charging for the same service. Dp. 59-61. Grossman did not keep Richards informed on the status of his investments, Richards found Grossman sloppy, and in the second quarter of 2008, Richards learned that both funds had "some very serious risks." Dp. 32-33, 92.

³⁵ The PPM for Anchor A, and presumably Anchor C, provided that an investment professional on the Advisory Board may be paid a fee. Dp. 202, 205.

On November 18, 2008, Adams informed Richards that redemptions of Anchor C shares had been suspended and that he could swap his shares for shares in PIWM. Dp. Ex. 21. Richards accepted the proposal of swapping his Anchor C shares for PIWM, which was managed by Battoo, because Anchor C was going bankrupt and he had no other choice. Dp. 99-100. Again, Richards was not told “of any compensation arrangements between [Sovereign,] Grossman, Adams or their affiliates and Battoo, BC Capital Group, S.A. (“BC Capital”) or their affiliates relating to investments in PIWM, a purported investment portfolio managed by BC Capital of which Battoo was a manager and adviser.” Dp. Ex. 21. According to Richards:

PIWM had exposure to the Madoff Ponzi scheme because PIWM had invested 10% of its assets in the Galaxy Fund, an Anchor affiliate, 6% in [Anchor A] and 6% in Harley International, an unrelated fund, all of which in turn had directly or indirectly invested substantially all of their funds with Madoff. In addition, PIWM had invested 3% of its assets in Anchor, Class E, an affiliated fund that had also suspended redemptions at approximately the same time as Madoff in [Anchor C].

Dp. Ex. 21.

Richards never signed an IAA with Sovereign. Sovereign sent him one on October 13, 2008, but by this time Richards had asked for the return of his funds and never signed it. Dp. 77-78; Dp. Ex. 21. Richard first received Sovereign’s Form ADV Part II on December 1, 2008. Dp. 83-84. Based on what he has been able to learn, Richards believes Grossman is a crook. Dp. 82-83. Richards estimates that he invested \$170,000 with Sovereign based on totally false disclosure by Grossman and lost it all. Dp. 111.

Since about mid-2008, Richards has been active with about twenty other persons who lost their Sovereign investments and he has filed several complaints for them and for him with the Commission. Dp. 131-33, 137, 150-51. At least half of the people are very unsophisticated and desperate, but some are knowledgeable. Dp. 132-34, 138-39. Richards’s IRA administrator could not get any information from Grossman and valued his IRAs at Sovereign at one dollar. Dp. 146-47. A number of Sovereign customers have told Richards that Grossman has threatened that they would get in trouble with their IRAs if they did not pay him a fee. Dp. 146.

Margaret S. Van Dyke and her husband (collectively Van Dyke), residents of Ohio, signed an IAA with Sovereign on March 11, 2008, after reviewing Sovereign’s website and talking with Grossman. Tr. 24-26; Resp. Ex. 103. Grossman represented he was better than most brokers because he had the skills of a certified investment management specialist and he targeted investments specifically for each individual investor. Tr. 26-28, 32. Van Dyke lost a significant amount of assets in 2007 when another asset manager was managing the account, and stressed to Grossman a need to protect the remaining retirement assets. Tr. 31-33.

Van Dyke understood that Grossman was charging a management fee of 0.90% on the assets under management, and Grossman told her this would be the only fee. Tr. 37-39, 41, 45-46. The IAA signed by Van Dyke stated

The advisor may receive performance-based compensation from certain investment companies. Advisor will notify clients in advance of any investments, the nature of any and all fees charged to the client and/or paid to advisor.

Tr. 37; Resp. Ex. 103 at 2. Van Dyke is not a knowledgeable investor; at the time, she did not know the meaning of performance-based fees, but based on conversations with Grossman she believed they were inapplicable to her situation. Tr. 33, 38-39, 50. Van Dyke testified that she never received a Form ADV Part II from Sovereign, however the signed IAA acknowledges receipt of the document. Tr. 44, 93-94.

Van Dyke had no notice from Sovereign of any fees charged to clients or received by the adviser other than the annual 0.90% fee and 4.5% fee to buy Anchor A, which Grossman strongly recommended as a safe fund of funds. Tr. 41, 48-50. Van Dyke was not told of any associations or arrangements between Sovereign and Anchor Hedge Fund that caused Grossman to receive fees. Tr. 62. Van Dyke sued Sovereign and Grossman in federal court in 2009 or 2010 and learned that the 4.5% fee she paid to put 60% of the Van Dyke assets into Anchor A was paid to Grossman and not to Anchor Hedge Fund as Grossman had represented.³⁶ Tr. 40-42, 59, 61, 63. Grossman represented that he had done due diligence on Anchor A and did not disclose that he was working for the fund. Tr. 51. The Van Dyke funds invested in Anchor A consisted of funds from two IRAs and a joint account. Tr. 78. At Grossman's direction, Van Dyke falsely signed papers stating that she was not a U.S. citizen to in order to invest in Anchor A. Tr. 67-68. An unsigned letter from Sovereign dated December 22, 2008, to Anchor A shareholders announced a "Suspension of determination of the net asset value (NAV) and consequent suspension of redemptions." Resp. Ex. 23.

Grossman did not tell Van Dyke that he owned Anchor Nevis or Anchor Florida, that their funds were pooled with other investor funds, that Van Dyke did not have an individual account in Anchor A, or that the account was in the name of Anchor Holdings. Tr. 71.

Van Dyke stopped dealing with Grossman in early October 2008, learned in October-November 2008 that Grossman had sold Sovereign, and learned in January 2009 that Anchor A was among the Madoff losses and investor money was gone. Tr. 53-54, 76. Van Dyke thought Grossman returned to Sovereign after he sold the company and was working with Adams. Tr. 54-55, 81, 83; Resp. Ex. 23. Van Dyke estimated suffering losses of \$1.5 million on the Anchor A investment and cashing in annuities at Grossman's direction. Tr. 86. She estimated losing \$2.2 million total as a result of dealing with Grossman and Adams. Tr. 86.

Grossman presented testimony from one investor witness.

C.W. Gilluly (Gilluly) is a college graduate, twelve-year former Navy pilot, and since 1980, a businessman with experience as chair or CEO of private and public companies. Gilluly is a sophisticated, aggressive investor and his wife is a conservative investor. Tr. 523, 530, 540.

³⁶ Van Dyke received a financial payment as a result of a settlement. Tr. 88-89.

From conversations and a face-to-face meeting with Grossman in 2003, Gilluly knew that an investor would pay Sovereign both an annual management fee of 1% and from 1% to 4.5% front-load fees on certain funds.³⁷ Tr. 525. Gilluly and his wife invested \$39,000 in Anchor A and \$100,000 in PIWM. Tr. 527, 539. Gilluly and his wife visited Grossman and Adams in 2009 and learned that Grossman had sold Sovereign to Adams. Tr. 527-28, 560. Gilluly understands that Anchor A had problems and got caught up in the Madoff scandal; he believes PIWM has not been impacted. Tr. 527-28.

Gilluly does not recall hearing about SIAM LLC based in Anguilla and was not aware of the referral agreement that SIAM LLC entered into with Anchor Management; he only remembers knowing about Sovereign located in Palm Harbor, Florida. Tr. 554. Gilluly's wife and another woman were able to redeem \$32,000 from PIWM in February 2006 and \$40,000 from the same account in 2007. Tr. 555-56. Gilluly and his wife were not able to withdraw \$156,000 from their Anchor Holdings account on May 10, 2011. Tr. 556-57.

Arguments of the Parties

Division's Posthearing Brief as to Grossman

In its initial posthearing brief, the Division argues that Grossman committed investment adviser fraud, breached his fiduciary duty, and committed other violations of the securities laws while he owned the Sovereign Entities and after he sold the companies to Adams. Div. Br. at 34-46. The Division contends that Grossman made a series of misrepresentations and omissions to Sovereign's clients to induce them to invest in the Battoo Funds, which resulted in Grossman's receipt of more than \$3.4 million in referral and consulting fees that he never disclosed to Sovereign's clients, in violation of Securities Act Section 17(a)(2) and Advisers Act Sections 206(1) and 206(2). Div. Br. at 34, 41. The Division also argues that Grossman violated Advisers Act Section 206(3) by failing to provide adequate written disclosures and obtain client consent that he was acting as a broker for the Battoo Funds, and Advisers Act Section 207 because Sovereign's Forms ADV Parts I and II contained material misstatements and omissions regarding Grossman's receipt of referral and consulting fees. *Id.* at 41, 43-44.

The Division argues that Grossman aided and abetted and caused Sovereign's violations of Advisers Act Section 206(4) and Rule 206(4)-2 by taking custody of client funds without providing investors with statements from qualified custodians or Sovereign regarding their money nor being subject to a surprise annual exam, and Advisers Act Rule 204-3 because Sovereign did not timely provide a brochure containing all information required by Form ADV Part II. *Id.* at 43, 45. The Division contends that Grossman also violated and aided and abetted and caused Sovereign's violations of Exchange Act Section 15(a) by acting as a broker while not registered as such with the Commission and while not an associated person of a registered broker or dealer. *Id.* at 46.

³⁷ Gilluly received a discount on the 4.5% fee as a member of the Oxford Club, an investors club in Baltimore, Maryland, which is where he met Grossman. Tr. 521-22, 526.

The Division also opposes Grossman's affirmative defenses regarding statute of limitations and estoppel. *Id.* at 46-54. The Division argues that Grossman's misconduct falls within the five-year statute of limitations period and even if the statute of limitations applied, it would only apply to its request for civil penalties. *Id.* at 47-51. The Division also argues that Grossman's estoppel affirmative defense was already ruled against at a prehearing conference. *Id.* at 51.

Grossman's Brief

Grossman's posthearing brief argues at considerable length that the remedies the Division seeks are barred by 28 U.S.C. § 2462's five year statute of limitations. Resp. Br. at 11-20. According to Grossman, *Gabelli v. SEC*, 133 S. Ct. 1216 (2013), "left [the door] wide open as to whether § 2462's statute of limitation is applicable to the Division's claims for disgorgement and [] injunctive relief" and should not be narrowly construed to apply § 2462's statute of limitations to fines, penalties, and forfeitures. Resp. Br. at 13. Grossman claims that all of the Division's claims first accrued before November 20, 2008, and therefore all remedies associated with each claim are barred by § 2462. *Id.* at 14. Grossman further argues that the Division's claims are not tolled by the continuing violation doctrine because the doctrine does not apply to discretely actionable acts occurring outside the limitations period. *Id.* at 21. Grossman argues that his work at Sovereign after the sale was on a consultancy basis and did not have anything to do with providing investment advice. *Id.* at 22.

In response to claims of misstatements and omissions, Grossman argues that Sovereign made "a number of disclosures" regarding the receipt of compensation received from the referral and international consultant agreements. *Id.* at 23. Grossman points to Sovereign's post-deficiency letter revisions to the IAA and Form ADV Part II, Anchor Hedge Fund PPMs, and oral conversations with Sovereign clients as evidence of these disclosures. *Id.* at 23-24. Grossman asserts that he also did not make material omissions and misstatements regarding Anchor Hedge Fund nor did he fail to conduct adequate due diligence or investigate red flags. *Id.* at 24-27.

Grossman argues that the Division's claim that the increased risk associated with the cross portfolio liability of the Anchor Hedge Fund share classes was not disclosed "is based on mere speculation" and that there is no evidence that supports this claim. *Id.* at 25.

Grossman argues that the Division produced no reliable evidence proving that Anchor A was not independently administered and audited. *Id.* Grossman asserts that he conducted continuous due diligence on Anchor A even after Battoo stopped providing him with information regarding the underlying funds, and that at the time he sold Sovereign, the delay in Anchor C's redemptions was not untimely, but part of the regular course of business. *Id.* at 25-27.

Grossman argues that there is no causal connection between his alleged violations and the Division's \$3,407,765.66 disgorgement request because the Division did not present evidence from each of Sovereign's clients to determine whether Grossman had any oral discussion of fees with them and because there is no causal connection between the violation of the custody rule and the fees received from the referral and international consultant agreements. *Id.* at 27.

Instead, Grossman suggests that disgorgement should be limited to the amounts connected to the four investors who provided testimony for the hearing and should be further “set-off” by payments Grossman made to private litigants and the IRS.³⁸ *Id.* at 27-28. Finally, Grossman argues that to the extent any civil penalties are imposed, they should be limited to a first-tier penalty. *Id.* at 28.

Division’s Reply to Grossman

The Division counters that its claims are not barred by § 2462 because *Gabelli* is limited to civil penalties and Commission and federal court precedent hold that equitable claims are not subject to § 2462. Div. Reply at 7-12. With respect to a civil penalty, the Division argues that Grossman engaged in misconduct within five years of the OIP, and his conduct outside that time period is considered timely under the continuing violations doctrine. *Id.* at 12-17.

The Division argues that Grossman did not disclose the fees and compensation he received from Sovereign clients under the referral and international consultant agreements, he misrepresented Anchor Hedge Fund to Sovereign clients, and failed to perform due diligence or investigate red flags on investments he recommended to investors. *Id.* at 18-24.

The Division reasserts its request for third-tier civil penalties. *Id.* at 34-35. The Division maintains that it showed a causal connection between Grossman’s violations and the disgorgement amount and disgorgement cannot be offset by settlement payments to Sovereign clients or the IRS. *Id.* at 31-34.

Division’s Brief as to Adams

The Division argues for the imposition of \$1,070,828 in disgorgement plus \$149,031 in prejudgment interest, and a third-tier civil penalty of \$1,070,828, representing Adams’s pecuniary gain as a result of the fraud at issue in this matter.³⁹ Div. Motion at 1. Strandell, who also testified at the hearing, determined that Battoo’s various entities transferred a total of \$894,118 into the Jyske Bank account during Adams’s ownership of Sovereign, and Adams additionally received two payments from PIWM on June 3, 2010, and August 31, 2010, totaling at least \$176,710. *Id.* at 7, Ex. A. The Division represents that it calculated prejudgment interest of \$149,031 in accordance with the delinquent tax rate established by the IRS, and assessed on a quarterly basis from August 31, 2010, the date Adams received the last payment from PIWM, until September 30, 2014, the date the Division filed its Motion. *Id.* at 8, Ex. A.

The Division argues that Adams’s conduct merits a third-tier civil penalty request of \$1,070,828, the amount of Adams’s pecuniary gain, because his conduct was egregious and recurrent and he demonstrated a high degree of scienter. *Id.* at 9-11. The Division contends that

³⁸ Grossman does not mention Davidson’s declaration.

³⁹ The \$1,070,828 disgorgement amount is from Sovereign’s and Jyske Bank books and records attached to the Strandell Declaration at Exhibit 1. Div. Motion at 6, Ex. A.

a substantial penalty is necessary and appropriate to punish Adams and to deter others from violating the federal securities laws. *Id.* at 9. The Division notes that courts have permitted an award based on each violation that occurred in a case and that here, there were fifteen payments in all that Adams received from Battoo. *Id.* at 9-10.

Adams's Opposition

Adams argues that the Division used a faulty methodology to determine the disgorgement amount because the Division omitted numerous payments and legitimate expenses from the calculation. Adams Opp. at 2. Adams believes that total payments of \$183,322.83, paid to Grossman, should be deducted because Adams did not retain these amounts in ill-gotten gains. *Id.* at 4-5. Adams also believes that legitimate business expenses, including office rent, accounting expenses, federal and state taxes, and payroll expenses, totaling \$304,135.84 should be deducted because they do not constitute a profit. *Id.* at 5. Adams contends the proper disgorgement amount is no more than \$583,369.40 plus prejudgment interest. *Id.* at 6.

Adams cites his bankruptcy filing in arguing the civil penalty amount should be much lower due to his financial circumstances. *Id.* at 7. He represents that he earns approximately \$1,000 each month in his part-time job, and will be financially unable to contribute to a significant financial judgment against him. *Id.* at 7-8.

Division's Reply to Adams

The Division rejects Adams's request that the disgorgement amount be decreased based on payments made to Grossman because Adams does not explain what the transfers were for nor does he provide case law to support the request. *Id.* at 2. Next, the Division argues that the disgorgement amount should not be reduced by Adams's claimed business expenses because (1) Adams failed to plead set-off as an affirmative defense; and (2) past Commission and Administrative Law Judge decisions have rejected this argument, in part because it would be unfair to allow a respondent to deduct expenses and thereby receive a benefit as a result, especially in situations where the expenses would have been incurred anyway even if there had been no fraud. *Id.* at 4-5. The Division argues that Adams waived the defense of inability to pay by not pleading it as an affirmative defense and not complying with Commission Rule of Practice 630, and argues that even if Adams had followed the correct procedure, the circumstances of this case outweigh consideration of the defense as a matter of law. *Id.* at 9-15.

Legal Conclusions

Grossman willfully violated Securities Act Section 17(a)(2) and Advisers Act Sections 206(1) and 206(2).⁴⁰

⁴⁰ Willful means that the person knows what he is doing. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (a finding of willfulness does not require intent to violate the law, but merely intent to commit the act which constitutes the violation).

Securities Act Section 17(a), the grandfather of all the anti-fraud provisions, created three separate offenses. Louie Loss, Joel Seligman, & Troy Paredes, *Fundamentals of Securities Regulation*, 1252 (6th ed. 2011). Specifically, Section 17(a)(2) makes it unlawful for any person in the offer or sale of any securities to obtain money or property by means of any untrue statement of a material fact or any material omission.⁴¹ 15 U.S.C. § 77q(a)(2).

In relevant part, Advisers Act Section 206 prohibits any investment adviser from: (1) employing any device, scheme, or artifice to defraud any client or prospective client; or (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), (2). Courts have interpreted Advisers Act Section 206 as imposing a fiduciary duty on an investment adviser to act at all times in the best interest of its clients and obligating investment advisers to provide “full and fair disclosure of all material facts” to its clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191, 194, 200-01 (1963).

Violations of Advisers Act Section 206(1) require a showing of scienter, which can be met by a showing of extreme recklessness; violations of Securities Act Section 17(a)(2) and Advisers Act Section 206(2) require a showing of negligence. *Aaron v. SEC*, 446 U.S. 680, 695-97, 701-02 (1980); *Capital Gains Research Bureau, Inc.*, 375 U.S. at 195; *SEC v. Steadman*, 967 F.2d 636, 641-42 & n.3, 643 & n.5 (D.C. Cir. 1992).

Grossman is a primary violator under Advisers Act Section 206, because as Sovereign’s founder, managing partner, and sole owner until he sold the business in October 2008, he received compensation in connection with giving investment advice and thus came within the broad statutory definition of an investment adviser. See 15 U.S.C. § 80b-2(a)(11); *Abrahamsen v. Fleschner*, 568 F.2d 862, 870 (2d Cir. 1977) (general partners of investment adviser considered investment advisers under Advisers Act Section 202(a)(11)); *Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *73-74 & n.196 (May 16, 2014) (investment adviser’s principal and sole owner liable as a primary violator under Advisers Act Sections 206(1) and 206(2)).

After October 2008, Grossman made it appear to Sovereign’s clients, including Gilluly, Montes, Richards, and Van Dyke, that he continued to advise and work with Adams to operate Sovereign, making statements such as:

I continue to remain on the Board of Advisors for [Sovereign]. I will be advising [Adams] on both my worldview, as it relates to investments, and in the latest asset protection strategies.

I have been and remain managing Director of [SIPS], responsible for the Pension side of the business. I want to assure you my office is only a few doors from [Adams’s] office and I will be actively involved in the day-to-day strategy

⁴¹ The OIP alleges violations of Securities Act Section 17(a) without specifying a subsection. OIP at 15-16. The Division’s initial posthearing brief focuses on Section 17(a)(2). Div. Br. at 34-35.

development as needed. You will see no interruption in the global perspective of Sovereign's investment strategies.

I ask that you give both [Adams] and I the continued privilege of serving you and your investment and asset protection needs.

Div. Ex. 64 at 2; Div. Ex. 151 at 4. In fact, Sovereign and SIPS worked out of the same office with, it appears, the same employees and office resources. Tr. 569, 576-77, 591-92, 594-95. Investors had difficulty distinguishing between the two. Tr. 147-48; *see* Tr. 596.

All the conduct that is at issue in this proceeding was accomplished using the means and instruments of interstate commerce including telephone calls, emails, wire transfers, and the internet. *See* 15 U.S.C. §§ 77q(a)(2), 80b-6; *SEC v. Tourre*, No. 10-cv-3229, 2013 WL 2407172, at *11 (S.D.N.Y. June 4, 2013); *Heyman v. Heyman*, 356 F. Supp. 958, 969 (S.D.N.Y. 1973); *cf. Rita J. McConville*, 58 S.E.C. 596, 619-20 (2005), *pet. denied*, 465 F.3d 780 (7th Cir. 2006).

Materially false and misleading statements and omissions

The standard of materiality is whether a reasonable investor would have considered the information important in deciding whether to invest. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Before 2008 and continuing through at least 2011, Grossman made materially false and misleading statements and omissions to prospective and current Sovereign clients, inducing Sovereign clients to make certain investments for which Grossman received undisclosed referral compensation. Grossman was responsible for Sovereign's brochures, advertisements, IAAAs and Forms ADV, which were materially misleading and contained several inaccurate statements and omissions. An investment adviser is a fiduciary and therefore has an affirmative obligation of utmost good faith to avoid misleading clients; this duty includes disclosure of all material facts, possible conflicts of interest, and the adviser's personal interests when making recommendations to clients. *See Capital Gains Research Bureau*, 375 U.S. at 194, 201; *Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003), *op. amended by* 335 F.3d 1096 (9th Cir. 2003).

The testimony provided by Sovereign clients Davidson, Montes, Richards, Van Dyke, and Gilluly demonstrates that what Grossman told them, and the documentation Sovereign furnished to prospective customers and customers contained patently false and misleading statements. *See supra* pp. 22-29; Div. Ex. 46B at 1; Tr. 51. Most significantly, Grossman represented that he offered highly personalized investment advice. This was false. Without any attention to an individual customer's preferences or financial situation, Grossman recommended the Battoo Funds; when customers followed his recommendation, he deposited their investments in a pooled single account, and then transferred customer investment funds into a pooled investment. Tr. 354, 453; Div. Ex. 50 at 4; Div. Ex. 50K; Dp. Ex. 5; Dp. Ex. 21 at 1-2; Resp. Ex. 105; Resp. Ex. 121; Resp. Ex. 134. Sovereign falsely represented these investments as "moderately conservative" or low risk and that they would provide improved returns over past investments for reduced risk and volatility. Tr. 48-51, 106, 118-19, 129, 154; Div. Ex. 46D at 11; Dp. 22; Resp. Ex. 99 at 10. Grossman also falsely represented that these hedge fund investments were "highly diversified with different managers, styles, and strategies"; that a

portfolio containing 35% Anchor A and 35% Anchor C was “moderately conservative”; and that Anchor A was suitable for “widows and orphans.” Div. Ex. 46D at 11; Div. Ex. 50 at 3; Div. Ex. 64 at 2; Dp. Ex. 5; Resp. Ex. 99 at 10. In fact, Anchor A was not highly diversified with different managers, styles, and strategies and Anchor A did not invest according to its representations in its PPM. Instead of bank deposits, fixed income securities, spot and forward exchange contracts, financial and commodity futures contracts, equities, exchange traded funds, options, derivatives, government and corporate debt, and other financial instruments, the underlying funds were invested in Madoff feeder funds. Div. Ex. 28 at 4; Div. Ex. 94 at 2; Resp. Ex. 27 at 4. Anchor A was not a safe investment and in fact turned out to be highly risky and thus unsuitable for a person’s primary retirement funds.

Anchor Hedge Fund PPMs failed to disclose the cross-portfolio liability of the various Anchor share classes; all of the assets of Anchor Hedge Fund were available to meet all of the liabilities of the Fund, regardless of the class to which the assets and liabilities were attributable. Div. Ex. 87 at 7; Div. Ex. 88 at 7; Div. Ex. 90 at 7; Resp. Ex. 33 at 10; Resp. Ex. 35 at 8; Resp. Ex. 41 at 8. Grossman did not present any evidence that he provided these financial statements to Sovereign clients.

Three of the five public witnesses were not familiar with private placements, yet not a single witness testified that Grossman told them that the private placements he recommended, and into which they transferred considerable retirement assets, were highly risky, unregistered securities unsuitable for IRA and other retirement funds. Richards and Van Dyke testified that they falsely represented they were not U.S. citizens on the fund application form because Grossman told them IRAs were not considered U.S. citizens.

Grossman’s statements to Sovereign clients were material because these investors entrusted their retirement funds to him to manage, relying on Grossman’s self-publicized expertise in managing investments.

The IAAs and Forms ADV filed and used by Sovereign both before and after the 2005 OCIE examination were misleading because they did not contain full and accurate disclosures to fully inform Sovereign clients that Grossman and Sovereign were receiving additional compensation due to Grossman’s and Sovereign’s investment recommendations. Specifically, the IAAs and Forms ADV in place prior to the 2005 OCIE examination did not disclose: the referral or international consultant agreements; that Grossman and Sovereign received compensation for investment referrals, acting as an international consultant, and performance-based fees; and that Sovereign took custody of its clients assets. *See supra* p. 17.

Grossman’s revisions in response to the OCIE examination did not provide Sovereign investors with a full and accurate picture. The revised IAA disclosure using the word “may” was misleading because it omitted any mention of the referral fees and the referral and international consultant agreements that had been in place since 2003. Tr. 41-42, 51, 62, 731; *see* Div. Ex. 79 at 2; Resp. Ex. 3 at 2. It was also misleading because Grossman did not notify clients of his receipt of performance-based fees, referral fees, and international consulting fees. Div. Ex. 50 at 2; Dp. 42-43, 49, 55; Dp. Ex. 20 at 3; Tr. 38-42, 61, 111-13. These omissions were material because had Davidson, Richards, and Van Dyke been aware of this compensation, they would

not have chosen to invest with Grossman and Sovereign. Tr. 62-63; Div. Ex. 50 at 2; Dp. 35-36; Dp. Ex. 21 at 6. “The existence of a conflict of interest is a material fact which an investment adviser must disclose to its clients because a conflict of interest ‘might incline an investment adviser – consciously or unconsciously – to render advice that was not disinterested.’” *SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1305 (S.D. Fla. 2007) (quoting *Capital Gains Research Bureau, Inc.*, 375 U.S. at 191-92).

Likewise, Sovereign’s revised Forms ADV after the OCIE examination remained misleading. Sovereign’s disclosure that it may receive incentive, subscription, and performance-based compensation from certain investment companies was inaccurate and misleading because it actually *was* receiving this compensation. *Supra* pp. 16-17. Additionally, Sovereign did not notify its clients who invested in the Battoo Funds that it had received fees due to their investing in those funds. Div. Ex. 50 at 2; Dp. 42-43, 49, 55; Dp. Ex. 21 at 3; Tr. 111-13, 123-24.

Grossman’s testimony that he notified Sovereign’s clients about the fees through the IAA, Forms ADV, in telephone conversations, over email, in the PPMs and subscription agreements is not credible. Tr. 725-27. Four of the five Sovereign investors who testified were emphatic that they did not know that the sales front load charged by Anchor A and Anchor C came back to Grossman and they had no knowledge that Grossman was receiving referral fees. Grossman’s witness Gilluly testified that during his initial meeting with Grossman, they discussed the 4.5% sales load fee, which Gilluly understood Sovereign would receive; however, he was unaware of the referral agreement. Tr. 524-25, 551, 554. Grossman testified that Sovereign clients were notified through the Anchor Hedge Fund PPMs that he would receive fees from Anchor Hedge Fund because he was appointed as a professional investment advisor to Anchor Hedge Fund and the PPM provides for an investment advisory fee. Tr. 872-74. The only part of the record that accurately discloses these fees are Anchor Hedge Fund’s consolidated financial statements for the year ended December 31, 2007. Div. Ex. 90 at 13; Div. Ex. 91 at 13. Grossman did not present any evidence that he provided these financial statements to Sovereign clients.

The IAAs and Forms ADV from 2003-2008 were additionally materially misleading because they did not disclose that Sovereign took custody of its clients assets. In fact, the IAAs, Forms ADV, and statements made by Grossman to investors specifically stated that Sovereign would not have custody of any client assets. *See supra* p. 10. These misstatements are material because the representation that an investment adviser will not retain custody of client assets provides an additional layer of security to investors; investment advisers who do not have custody cannot improperly access client funds. Additionally, investment adviser custody is separately regulated by Advisers Act Section 206(4) and Rule 206(4)-2.

Additionally, although the IAA included a disclaimer stating that “Client’s signature below acknowledges that Client has received and has had the opportunity to read the Advisor’s Form ADV Part II,” Sovereign did not timely provide its Form ADV Part II to all of its clients. Tr. 43-44, 93-94; Div. Ex. 50 at 1; Div. Ex. 79 at 4; Div. Ex. 129 at 4; Resp. Ex. 1 at 3; Resp. Ex. 3 at 4.

Inadequate due diligence and failure to investigate red flags

An investment adviser owes a fiduciary duty of care to its clients. *Capital Gains Research Bureau, Inc.*, 375 U.S. at 194, 201. Grossman did not perform reasonable due diligence before recommending Anchor A and the other Battoo Funds to Sovereign's clients. Grossman admitted that Battoo failed to provide him with basic information, such as the underlying investments, about the funds into which Grossman placed Sovereign customers. These red flags should have raised concerns that Grossman was obliged to resolve. Grossman violated his fiduciary obligations by failing to do so.

In addition, Grossman violated the duty of care he owed to his customers by relying on PerTrac reports, one-page fund summaries allegedly prepared by the fund's independent administrator, without even knowing if Battoo was the source of the information. In fact, the Battoo Funds were not independently managed and administered. All parties involved in the management of the Battoo Funds were in some way connected with Battoo.⁴² Therefore, the PerTrac reports relied on by Grossman in conducting his due diligence on the Battoo Funds were not reliable because Folio Administrators was not an independent fund administrator. Additionally, the financial statements and asset verification reports for Anchor A are called into question because the director of Anchor A, Fiduciary Group Limited, was responsible for these tasks. *See* Div. Ex. 90 at 7.

Given an opportunity at the hearing, Grossman failed to show that he performed anything approaching adequate due diligence as to the investments in which he recommended that Sovereign customers invest funds.

⁴² Cann and Keuls served as directors for both the investment manager for Anchor Hedge Fund, Anchor Management, and the investment manager for FuturesOne, Innovative. Div. Ex. 25 at 5, 12-13; Div. Ex. 28 at 5, 12; Div. Ex. 66 at 5, 13-14; Div. Ex. 67 at 5, 13; Resp. Ex. 27 at 5, 12; Resp. Ex. 54 at 5, 13. Both Anchor Management and FuturesOne were controlled by Battoo: BC Hong Kong owned 65% of Anchor Management and BC Capital owned 100% of Innovative. Div. Ex. 19 at 6, 9-10, 17, Ex. 7 at 3.

Keuls was a director of BC Panama until May 31, 2009, and BC Hong Kong until June 30, 2012. Div. Ex. 73 at 5; Mem. of Law in Supp. Of Mot. to Hold Def. Battoo and his Liquidators in Contempt, *CFTC v. Battoo*, 12-cv-7127 (N.D. Ill. Mar. 4, 2013), ECF Nos. 82-2 (Ex. B at 2147), 82-6 (Ex. F at 1-2).

Both Cann and Keuls served as directors of PIWM and Keuls “[ran] family offices through the PIWM.” Div. Ex. 30 at 4525; Resp. Ex. 62 at 2.

Cann was a member of BC Hong Kong’s professional executive board. Div. Ex. 19 at Ex. 1.

Cann was a director of Fiduciary Group Limited (the corporate director of Folio Administrators). Resp. Exs. 13-14.

Battoo even considered Grossman “part of [PIWM].” Div. Ex. 30 at 4525.

Grossman acted with scienter

Based on the conduct described above, Grossman willfully violated Securities Act Section 17(a)(2) and Advisers Act Sections 206(1) and 206(2) because he committed these actions while acting with scienter, that is, at a minimum, with extreme recklessness.

Scienter is defined as a mental state consisting of intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Reckless conduct satisfies the scienter requirement. *Vernazza*, 327 F.3d at 860; *SEC v. Steadman*, 967 F.2d at 641. Recklessness is an “extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” *SEC v. Steadman*, 967 F.2d at 641-42 (ellipses in original) (quoting *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

The evidence is overwhelming that Grossman acted with a high degree of scienter or with extreme recklessness. He falsely represented that he was going to give individual attention to a client’s investment needs and advised Sovereign clients to invest primarily in high risk investments which he knew little about. Grossman intentionally concealed the fact that he received referral and consulting fees in exchange for recommending specific investments to Sovereign clients. He told some of his customers to lie in classifying themselves as non-U.S. citizens. Even after OCIE notified Grossman in 2005 that his conduct was in violation of the federal securities laws, Grossman did not change his behavior. Moreover, he falsely notified OCIE that he had revised Sovereign’s IAA and Form ADV Part II in accordance with OCIE’s recommendations. Grossman’s belief that the revision he made to include the word “may” on the revised form was done in reliance on OCIE’s delinquency letter is not credible. “May” is “used to indicate possibility or probability.” Merriam-Webster’s Collegiate Dictionary 718-19 (10th ed. 2001). At the time Grossman revised the IAA and Form ADV Part II, payments to Grossman were not a possibility, they were a fact.

With respect to his fiduciary obligations, Grossman was reckless in not performing adequate due diligence and investigating red flags as they arose. As an industry professional for his entire career, the owner of an investment advisory firm, who advertised himself as a Certified Financial Planner and a Certified Investment Management Analyst, Grossman should have been well-versed in his fiduciary duties. *Montford & Co.*, Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, at *56 (May 2, 2014).

As Grossman acted with scienter, his conduct was willful. *Donald L. Koch*, 2014 SEC LEXIS 1684, at *49 n.139.

Grossman willfully violated Advisers Act Section 207.

Advisers Act Section 207 prohibits any person willfully making any untrue statements of material fact in any registration application or report filed with the Commission under Section 203 or 204, or willfully omitting to state in any such application or report any material fact that is required. 15 U.S.C. § 80b-7; see 17 C.F.R. § 275.204-1; *Vernazza*, 327 F.3d at 856, 858; *K.W.*

Brown & Co., 555 F. Supp. 2d at 1309; *Montford & Co.*, 2014 SEC LEXIS 1529, at *68. A Form ADV is a required report, and the Commission has “stated that Form ADV and its amendments embody a basic and vital part in our administration of the Advisers Act, and it is essential in the public interest that the information required by the application form be supplied completely and accurately.” *Montford & Co.*, 2014 SEC LEXIS 1529, at *68 (internal quotation marks and alteration brackets omitted). Scienter is not required to find a violation of Advisers Act Section 207. *Id.*

Grossman violated Advisers Act Section 207 by not disclosing on Sovereign’s Form ADV that Grossman was receiving additional compensation paid into SIAM LLC. Div. Ex. 50 at 2; Dp. 42-43, 49, 55; Dp. Ex. 21 at 3; Tr. 111-12, 123-24; *see supra* pp. 35-36. Before the 2004 OCIE examination, Sovereign’s Form ADV Part I, Items 5.E, 6.B(1), 6.B(3), and 9 were materially inaccurate or misleading. Item 5E should have disclosed the fees and compensation paid to SIAM LLC and Grossman under the referral and international consultant agreements, but did not. Item 6.B(1) inaccurately represented that Sovereign was not actively engaged in any other business other than giving investment advice to clients; Item 6.B(3) inaccurately represented that it did not sell products or provide services other than investment advice to its advisory clients; and Item 9 inaccurately represented that Sovereign did not have custody of its advisory clients’ cash or securities. OCIE’s 2005 post-examination deficiency letter noted three additional inaccuracies and advised Sovereign to update accordingly. *See* Div. Ex. 141 at 4; *supra* pp. 18-19.

As discussed above, Grossman’s post-OCIE examination revisions were inadequate to resolve these deficiencies. *See supra* p. 35-36. Grossman’s revisions to three items in Form ADV Part I, failed to address and resolve the inaccuracies in Items 5.E, 6.B(1), 6.B(3), and 9. *See supra* p. 20. As previously discussed, these misstatements and omissions were material. *See supra* pp. 35-36. Accordingly, Grossman willfully violated Advisers Act Section 207. *See supra* p. 38.

Grossman willfully violated Exchange Act Section 15(a).⁴³

Exchange Act Section 15(a) prohibits a broker or dealer to make use of the mails or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission, is an associated person of a registered broker-dealer, or satisfies the conditions of an exemption or safe harbor. 15 U.S.C. §78o(a). Scienter is not required for a violation of Exchange Act Section 15(a). *See SEC v. Montana*, 464 F. Supp. 2d 772, 785 (S.D. Ind. 2006).

⁴³ The OIP also charged Grossman with willfully aiding and abetting and causing violations of Exchange Act Section 15(a). OIP at 15. I have found that Grossman committed a primary violation. For this reason, I decline to find that the same conduct willfully aided and abetted and caused the same violation. I note however that Adams’s settlement order found that Adams both willfully violated and willfully aided and abetted and caused violations of Exchange Act 15(a), *Larry C. Grossman*, 2014 SEC LEXIS 1261, at *27. I decline to do so for Grossman since I already found Grossman willfully violated Exchange Act Section 15(a).

A broker is described in Section 3(a)(4) of the Exchange Act as “any person engaged in the business of effecting transactions in securities for the account of others,” and factors to be considered in making a determination are whether the person: received commissions; was involved in the negotiations between the issuer and the investor; made valuations as to the merits of the investment or gave advice; sold the securities of other issuers; and actively found investors. 15 U.S.C. § 78c(a)(4); *see SEC v. Zubkis*, No. 97 Civ. 8086, 2000 WL 218393, at *28 (S.D.N.Y. Feb. 23, 2000). Other factors include the dollar amount of securities sold and the extent of advertisement and investor solicitation. *See SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 12-13 (D. D.C. 1998).

Grossman knowingly acted as a broker when he recommended the Battoo Funds to Sovereign clients and received referral fees and a portion of the investment management fee for making those recommendations. Grossman was not registered with the Commission as broker or dealer, nor was he associated with a registered broker or dealer, and thus willfully violated Exchange Act Section 15(a). *See supra* p. 3; *see, e.g.*, Div. Ex. 40 at 6.

Grossman willfully violated Advisers Act Section 206(3).

Advisers Act Section 206(3) makes it unlawful for any investment adviser acting as broker for a person other than the adviser’s own client to knowingly sell or purchase any security from that person for the client, without disclosing to the client in writing before the completion of the transaction the capacity in which the adviser is acting and obtaining the consent of the client to the transaction. 15 U.S.C. § 80b-6(3).

There does not appear to be any definitive ruling on whether scienter is required for an Advisers Act Section 206(3) violation. I faced the issue recently and ruled that a showing of scienter was not required. *See Tri-Star Advisors, Inc.*, Admin. Proc. Rulings Release No. 1478, 2014 SEC LEXIS 1872, at *19 (June 2, 2014) (“Though no court has directly opined on whether Advisers Act Section 206(3) requires a showing of scienter, the context of the statute shows that scienter is not an element. . . . Advisers Act Section 206(1) . . . requires a showing of scienter. . . . Section 206(3), unlike Section 206(1), does not include any language relating to fraud.”); *Mark N. Geman*, Exchange Act Release No. 43963, 2001 SEC LEXIS 282, at *32 (Feb. 14, 2001) (“[Advisers Act Section 206(3)] can be violated without a showing of fraud.”), *aff’d*, 334 F.3d 1183 (10th Cir. 2003). Grossman has not addressed the issue and the Division cites *Geman*; therefore, my judgment is that scienter is not required for an Advisers Act Section 206(3) violation.

On these facts, Grossman acted as a broker selling shares of the Battoo Funds and received compensation for effected sales to Sovereign customers. Grossman did not disclose the existence of the three referral agreements with the Battoo Funds to Sovereign clients. The disclosures provided in Sovereign’s IAA and Forms ADV were inadequate and misleading and as a result, Sovereign clients were unaware that Grossman received additional compensation based on his investment recommendations. If some of Sovereign’s clients had been aware of Grossman’s conflict of interest created by the receipt of compensation for their investment in the Battoo Funds, they would not have invested with Sovereign. Tr. 62-63; Div. Ex. 50 at 2; Dp. 35-36.

Grossman willfully violated Advisers Act Section 206(3) because he purposefully did not provide written disclosure to Sovereign clients and obtain their consent before he sold them shares of the Batttoo Funds and received undisclosed compensation as a result.

Grossman willfully aided and abetted and caused violations of the Advisers Act Section 206(4) and Advisers Act Rule 206(4)-2.

Advisers Act Section 206(4) makes it unlawful for an investment adviser to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. 15 U.S.C. § 80b-6(4). Scienter is not required to establish a violation of Advisers Act Section 206(4). *SEC v. Steadman*, 967 F.2d at 647.

Rule 206(4)-2 imposes several obligations on investment advisers that maintain custody and possession on their clients' funds. In pertinent part, Rule 206(4)-2 requires an investment adviser that has custody of client assets to (1) maintain them with a qualified custodian, who must hold the assets in an account under the client's name or under the adviser's name as agent or trustee for the clients; (2) provide notice to clients regarding the account; (3) provide account statements to clients, which can be satisfied through a reasonable belief that the qualified custodian sends an account statement at least quarterly; and (4) if the qualified custodian does not send account statements directly to clients, the adviser must send quarterly account statements to clients and undergo an annual surprise examination by an independent public accountant to verify the clients' assets in custody. 17 C.F.R. § 275.206(4)-2(a)(1)-(4); *Custody of Funds or Securities of Clients by Investment Advisers*, Advisers Act Release No. 2176, 2003 SEC LEXIS 2277, at *20 (Sept. 25, 2003). Custody is defined as "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them" and includes custody by a related person. 17 C.F.R. § 275.206(4)-2(d)(2). An adviser can have custody of client assets, even when it possesses these assets for a brief period of time. *See Custody of Funds or Securities of Clients by Investment Advisers*, 2003 SEC LEXIS 2277, at *6.

The criteria for aiding and abetting liability are that: (1) a principal committed a primary violation; (2) the alleged aider and abettor provided substantial assistance to the primary violator; and (3) the alleged aider and abettor provided such assistance with the necessary scienter, i.e., that he rendered such assistance knowingly or recklessly. *See Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *Phlo Corp.*, Exchange Act Release No. 55562, 2007 SEC LEXIS 604, at *35 (Mar. 30, 2007).

Sovereign violated Advisers Act Section 206(4) and Rule 206(4)-2 when it took custody of its clients' assets through related party Anchor Holdings Florida's EverBank account without complying with Rule 206(4)-2's requirements. Sovereign clients' assets were pooled together into one account that belonged to Anchor Holdings Florida; the account was not associated in any way with any client. Tr. 224-26, 229. Sovereign clients did not realize they were transferring their funds to Sovereign because Sovereign represented to them that it would not have custody of its clients' assets and the similarity in names of Anchor Florida and Anchor Hedge Fund; in fact, due to these similar names, Sovereign's clients believed their money was going directly to Anchor Hedge Fund. *Supra* p. 10; *see, e.g.*, Div. Ex. 50 at 5; Div. Ex. 64 at 1.

Sovereign did not provide its clients with statements from the EverBank account and was not subject to a surprise annual audit during Grossman's ownership. Tr. 201, 231, 755-56.

Grossman willfully aided and abetted and caused violations of the Advisers Act Section 206(4) and Advisers Act Rule 206(4)-2 because: he knew that Sovereign clients were not receiving the required statements and that Sovereign was committing a violation; he provided substantial assistance to Sovereign in its violation by forming Anchor Holdings Florida, instructing Sovereign clients to wire their funds to the EverBank account, and being the signatory on the account; and he knowingly assisted Sovereign's violations. Tr. 173, 228; Resp. Ex. 95. Although Grossman testified that he did not know he was required to provide Sovereign clients with copies of the EverBank account statements because the money was only in the account for a "very short" time, a person cannot escape aiding and abetting violations by claiming ignorance of his obligations under the securities laws. Tr. 231, 755-56; *see Sharon M. Graham*, Exchange Act Release No. 40727, 1998 SEC LEXIS 2598, at *28 n.33 (Nov. 30, 1998). At a minimum, as the owner of a registered investment adviser, Grossman should have known the custody rules imposed by the Advisers Act.

Grossman willfully aided and abetted and caused violations of Advisers Act Rule 204-3.

Advisers Act Rule 204-3 requires registered investment advisers to deliver a brochure and one or more brochure supplements to each client or prospective client that contains all information required by Form ADV Part II. 17 C.F.R. § 275.204-3(a). The brochure must be delivered to the client or prospective client before or at the time the investment advisory contract is entered and annually, if there are any material changes since the last update. 17 C.F.R. § 275.204-3(b)(1)-(2).

Sovereign did not provide either Richards or Van Dyke with a Form ADV Part II at the start of the adviser relationship, and Davidson had to request one. Tr. 43-44, 93-94; Div. Ex. 50 at 1; Dp. 83-84. Montes does not know what a Form ADV Part II is; she signed an IAA saying she received one, but she did not understand the paperwork she was required to sign. Tr. 108, 113, 149-50. As has been noted, Sovereign's Form ADV Part II contained material errors and omissions.

The preponderance of the evidence is that Sovereign violated Advisers Act Rule 204-3 by not delivering an investment adviser brochure and supplements to each client or prospective client that contained correct information required by Part II of Form ADV, and that Grossman aided and abetted and caused all these violations because he was Sovereign's owner, sole control person, and firm spokesperson, from 2003 through October 1, 2008, and thus responsible for Sovereign's compliance with this rule. *See* Div. Ex. 79 at 4; Div. Ex. 129 at 4; Resp. Ex. 1 at 3; Resp. Ex. 3 at 4.

Sanctions

The Division seeks disgorgement of \$3,407,765.66 plus prejudgment interest, third-tier civil penalties of \$3,407,765.66, a cease-and-desist order, and an industry bar for Grossman, and disgorgement of \$1,070,828, prejudgment interest in the amount of \$149,031, and a third-tier penalty in the amount of \$1,070,828 for Adams.

Statute of Limitations

A third of Grossman's brief seeks to establish that remedies arising from the Division's claims against Grossman are barred by 28 U.S.C. § 2462. Resp. Br. at 11-20. Grossman contends that all of the Division's requested sanctions are barred by 28 U.S.C. § 2462, which provides that the statute of limitations is five years for the enforcement of any civil fine, penalty, or forfeiture. 28 U.S.C. § 2462. In support of his position, Grossman cites to *Gabelli v. SEC*, 133 S. Ct. 1216 (2013), and *SEC v. Graham*, Case No. 13-10011-CIV-KING, 2014 U.S. Dist. LEXIS 64953 (S.D. Fla. May 12, 2014). In *Gabelli*, the Supreme Court held that in government enforcement actions seeking civil penalties, § 2462's statute of limitations begins to run when the violation occurs, not when it is discovered. 133 S. Ct. at 1220-24. *Graham* would extend the Supreme Court's holding to cover disgorgement, injunctions, and declaratory relief in addition to civil penalties. *Graham*, 2014 U.S. Dist. LEXIS 64953, at *24-30. Based on these two decisions, Grossman argues that the Supreme Court left the door wide open as to whether equitable remedies were subject to the five-year statute of limitations of § 2462, which the Southern District of Florida stepped through in making its ruling.

The Division devotes more than a third of its reply brief disputing Grossman's interpretation of the *Gabelli* decision, and noting *Graham*'s lack of precedential value as a Southern District of Florida decision. Div. Reply 6-17. The Division argues first that *Gabelli* only covers civil penalties, and further that its claim for a civil penalty is not time barred because under the continuing violations doctrine, Grossman committed violations within five years of the OIP, and therefore similar misconduct that occurred outside the five-year limitations period can be considered. *Id.* at 16-17.

My reading of *Gabelli* and later cases is that *Gabelli* addressed § 2462 as it applied to civil penalties, not cease-and-desist and disgorgement orders. 133 S. Ct. at 1219, 1220 n.1. My understanding is supported by federal court decisions, which hold that § 2462 does not apply to equitable remedies such as a cease-and-desist orders and disgorgement.⁴⁴ See, e.g., *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 280-81, 288 n.8 (2d Cir. 2013); *Riordan v. SEC*, 627 F.3d 1230, 1234-35 (D.C. Cir. 2010); *Johnson v. SEC*, 87 F.3d 484, 489-92 (D.C. Cir. 1996); *SEC v. Geswein*, 2 F. Supp. 3d 1074, 1084-85 (N.D. Ohio 2014); *SEC v. Syndicated Food Serv. Int'l*, No. 04-cv-1303, 2014 U.S. Dist. LEXIS 42532, at *59 (E.D.N.Y. Feb. 14, 2014).

Having determined that *Gabelli* is applicable only to the ordering of civil money penalties and industry bars, I turn next to determining whether Grossman committed the violations that are the subject of this Initial Decision after November 20, 2008. I find that he did so for a considerable period of time.

⁴⁴ The Division's position is that the five-year statute of limitation does not apply to industry bars because it is an equitable remedy. Div. Reply at 9-12. *Johnson v. SEC* held that a censure and suspension are punitive and fall within the meaning of § 2462. 87 F.3d at 492.

First and foremost, Grossman violated the fiduciary duty he owed to his investment adviser clients by failing to notify Sovereign clients well beyond November 20, 2008, that he had sold the business to Adams on October 1, 2008, and that he would no longer be serving as an investment adviser.⁴⁵ Investment advisers have an “affirmative duty of utmost good faith, and full and fair disclosure of all material facts.” *Capital Gains Research Bureau*, 375 U.S. at 194 (internal quotation marks omitted). Grossman failed to abide by such standards. Grossman did not explicitly notify Sovereign clients that he had sold the business to Adams and would no longer be serving as an investment adviser. None of the clients who testified at the hearing or provided written declarations was aware that Grossman had sold Sovereign and intended to terminate the investment advisory relationship. In fact, many of them believed that Grossman continued to be their investment adviser well into 2009, which falls within the statute of limitations period. The October 14, 2008, email to Sovereign clients purportedly announcing the transfer was vague and did not clearly announce the sale. It implied that Adams was joining Grossman at Sovereign and did not explicitly state that Grossman was leaving the company; in fact, Grossman pointed out that he would remain on the Board of Advisors for the company, be “advising Greg on both [his] worldview, as it relates to investments, and in the latest asset protection strategies,” and be “actively involved in the day-to-day strategy development as needed.” Div. Ex. 64 at 2. Grossman also mentioned that he would be continuing his role with SIPS, which shared an office with Sovereign, and asked for the continued privilege of serving Sovereign clients for their investment and asset protection needs. It is clear from the testimony of the five witnesses that they chose Sovereign as their investment adviser because of Grossman. No one knew Adams. It is likely that Grossman omitted to tell Sovereign’s clients material information because it would mean they would leave Sovereign.

In addition, the evidence shows continued acts of misrepresentation and omission by Sovereign after Adams became its owner, and the evidence is that Grossman played a significant role in those actions.⁴⁶ Grossman remained on Sovereign’s payroll as a consultant after October 1, 2008, and rejoined Sovereign as Managing Director in January 2009. Grossman’s Investment Adviser Representative Public Disclosure Report shows that he was registered with Sovereign until December 31, 2011. Div. Ex. 2. Grossman played a significant role in trying to resolve the issues with Sovereign clients’ Anchor A investments. He helped notify clients about the issue and assisted them in trying to recover their money. Grossman and Adams both informed Davidson on Sovereign letterhead in early February 2009 that Anchor A had suspended redemptions and the calculation of NAV. Div. Ex. 50 at 6; Div. Ex. 50P at 2. Grossman hired an attorney to assist with filing claims with the Madoff receiver and in so doing advised Sovereign clients as well. Tr. 760; Div. Ex. 50 at 6-7; Div. Ex. 50R; Div. Ex. 50S.

⁴⁵ Davidson for example, found out on November 24, 2008, that Adams was Sovereign’s president and investment manager. Div. Ex. 50 at 7. Gilluly first learned that Grossman sold the company in early 2009. Tr. 527-28.

⁴⁶ The Division maintains that Grossman advised Sovereign clients by sending two letters to two investors on November 21, 2008, regarding their exchange of Anchor C shares for PIWM shares. Paturzo’s testimony disputes this charge and I have not relied on those letters in reaching a conclusion.

Gilluly had a face-to-face meeting sometime in the February to April 2009 period to discuss Sovereign's situation vis-à-vis the Madoff situation with Grossman and Adams. Tr. 527-28, 560. On July 15, 2009, Sovereign sent out a letter to Davidson and presumably other Sovereign clients, signed by Grossman and Adams, regarding the efforts to recover funds. Div. Ex. 50S. At no time in his communication with Sovereign customers, except Gilluly, did Grossman verbally disclose that he had received payments from referring clients to Anchor Hedge Fund.

According to Gilluly, Grossman was advising Sovereign investors about their Sovereign investments in 2011. Tr. 558-59. On June 28, 2011, Gilluly wrote to an investor who like him was frustrated and agitated at not being able to receive his Sovereign investments that “[i]t’s great that [Grossman] is willing to be so ‘transparent.’” Tr. 559. In addition to his assistance with Anchor A, Grossman tried to salvage Sovereign’s business by speaking with and directing new clients to Sovereign through December 2010. *See* Div. Ex. 119; Div. Ex. 120; Div. Ex. 123. Grossman’s signature also appeared on Sovereign’s December 23, 2008, Form ADV filed with the Commission and he was also listed as Sovereign’s contact employee. Div. Ex. 84A at 3, 30.

Having established timely violations, the issue is whether the continuing violation doctrine allows consideration of Grossman’s violations that began outside the statute of limitations in considering a civil money penalty. Under the continuing violations doctrine, a complaint is timely filed if the alleged unlawful practice continues into the limitations period. *SEC v. Kovzan*, Case No. 11-cv-2017, 2013 U.S. Dist. LEXIS 147947, at *6 (D. Kan. Oct. 15, 2013); *see Havens Realty Corp. v. Coleman*, 455 U.S. 363, 380-81 (1982). To be considered, the continued violations must be a part of a wider scheme and not separate, discrete acts, even if those acts are related to or part of a series with acts committed within the limitations period. *SEC v. Leslie*, No. C 07-3444, 2010 WL 2991038, at *35 (N.D. Cal. July 29, 2010) (finding that the SEC had alleged a continuous, integrated scheme that was operated by the same group of people over a period of time to achieve the same purpose); *Kovzan*, 2013 U.S. Dist. LEXIS at *7; *see National Railroad Passenger Corp. v. Morgan*, 536 U.S. 101, 113-15 (2002).

Grossman’s conduct outside and within the limitations period was part of one continuous scheme to defraud investors. Grossman represented to Adams that the sale of Sovereign would not “materially adversely affect the relationships” of Sovereign with its clients. Div. Ex. 1 at 10. Several investors testified that had they known Grossman was planning to sell the business, they never would have invested their money with him. Grossman’s material misrepresentations and omissions were necessary to keep Sovereign viable. There is considerable case law in support of the proposition that the federal securities laws should be construed not technically, but flexibly to effectuate their remedial purposes. *See SEC v. Zanford*, 535 U.S. 813, 819 (2002) (citing *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972)). I find the continuing violations doctrine applicable here and will consider Grossman’s pre-November 20, 2008, conduct in assessing civil penalties and whether to impose the industry bars. As detailed in the Findings of Facts and Legal Conclusions, Grossman engaged in a scheme to defraud Sovereign’s investment adviser clients and violated other provisions of the securities statutes, rules, and regulations for a long period.

Civil Penalties

In summary, Exchange Act Section 21B(a) and Advisers Act Section 203(i) authorize the Commission to impose civil monetary penalties in any cease-and-desist proceeding against any person after notice and opportunity for hearing where penalties are in the public interest and the person (1) has willfully violated, or aided and abetted violations of, certain provisions of the securities laws or rules or regulations; or (2) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission. 15 U.S.C. §§ 78u-2(a), 80b-3(i). Securities Act Section 8A(g) authorizes the Commission to impose civil monetary penalties in any cease-and-desist proceeding against any person after notice and opportunity for hearing where penalties are in the public interest and the person has violated or caused the violation of any provision of the Securities Act or its rules and regulations. 15 U.S.C. § 77h-1(g). The statutes set out a three-tiered system for determining the maximum civil penalty for each act or omission. A maximum third-tier penalty is permitted if (1) the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and (2) such act or omission 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.⁴⁷ 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3), 80b-3(i)(2)(C).

To determine whether a penalty is in the public interest, the statutes call for consideration of: (1) whether the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm caused to others; (3) unjust enrichment, taking into account any restitution made; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. 15 U.S.C. §§ 78u-2(c), 80b-3(i)(3).

As to Grossman: My judgment is that it would serve the public interest and the objective of deterrence for Grossman to receive a third-tier penalty. Grossman acted with scienter because he knowingly, or with extreme recklessness, willfully and blatantly violated the fiduciary duty he owed his customers as their investment adviser. The evidence shows that Grossman was deceitful and manipulative both in his representations as to how he would invest customer funds and the information he provided to customers and in his filings with the Commission; Grossman caused losses of over a million dollars to two people and the loss of the entire retirement account of a non-accredited investor; and he enriched himself by at least several million dollars. This Initial Decision finds that Grossman willfully violated Securities Act Section 17(a); Exchange Act Section 15(a); Advisers Act Sections 206(1), 206(2), 206(3) and 207, and that he willfully aided and abetted and caused Sovereign's violations of Advisers Act Section 206(4) and Rules 204-3 and 206(4)-2. Grossman has neither acknowledged wrongdoing nor shown remorse for the financial losses that he has caused.

⁴⁷ “To impose second-tier penalties, the Commission must determine how many violations occurred and how many are attributable to each person.” *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012). Presumably, the same approach should be taken with respect to civil penalties at the third-tier level.

I read *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012), as requiring a specific number of violations for the imposition of a penalty.⁴⁸ Although it is impossible to ascertain the exact number of Grossman's illegal actions, not imposing any penalty would not serve the interests of justice. *See V.F. Minton Sec., Inc.*, Exchange Act Release No. 32074, 1993 SEC LEXIS 642, at *21-22 (Mar. 31, 1993) (finding that "nothing less than the bar and revocation . . . will suffice to protect the public from further misconduct" after respondents recommended unregistered securities without adequate basis), *aff'd*, 18 F.3d 937 (5th Cir. 1994); *First Sec. Transfer Sys., Inc.*, Exchange Act Release No. 36183, 1995 SEC LEXIS 2261, at *13 (Sept. 1, 1995) ("A steep monetary penalty will assist in impressing . . . the seriousness of [respondent's] obligation to comply with the law.").

A reasonable resolution of the dilemma is to take the number of investor witnesses who testified as to losses, five, and the number of false Commission filings, seven, and to multiply that number by the maximum amount of third-tier penalties in effect from August 1, 2003, through at least December 2010.⁴⁹ Div. Ex. 71; Div. Ex. 119. The maximum amount of civil penalty for each act or omission in violation of the antifraud provisions of the securities statutes at the third tier was \$120,000 for a natural person for misconduct prior to February 5, 2005, \$130,000 for a natural person prior to March 3, 2009, and \$150,000 for a natural person after March 3, 2009. *See* 17 C.F.R. § 201.1002, Subpt. E, Table II; 17 C.F.R. § 201.1003, Subpt. E, Table III; 17 C.F.R. § 201.1004, Subpt. E, Table IV. Given that most of Grossman's illegal activities occurred between February 5, 2005, and March 3, 2009, I will assess a civil penalty of \$130,000 for each of eleven violations. The twelfth violation, representing the February 12, 2004, Form ADV, will be assessed for \$120,000. The total civil penalty is \$1,550,000.

As to Adams: I reject the Division's argument that Adams should receive a third-tier civil money penalty in the amount of his ill-gotten gain, and I reject Adams's argument that he should be assessed a substantially lower penalty based on his present financial situation. As discussed above with respect to Grossman, I find *Rapoport* controlling. A monetary penalty is designed to serve as a deterrent against securities law violations. *See SEC v. Peter C. Lybrand*, 281 F. Supp. 2d 726, 729 (S.D.N.Y. 2003) (citing *SEC v. Palmisano*, 135 F.3d 860, 866 (2d. Cir. 1998); *SEC v. Tanner*, 02 Civ. 306, 2003 WL 21523978, *2 (S.D.N.Y. July 3, 2003); *SEC v. Moran*, 944 F. Supp. 286, 296 (S.D.N.Y. 1996); H.R. Rep. No. 101-616 (1990), Report of the Committee on Energy and Commerce of the U.S. House of Representatives on the Securities Enforcement Remedies and Penny Stock Reform Act of 1990).

⁴⁸ The Division cites to *SEC v. KS Advisors, Inc.*, No. 2:04-cv-105-FTM-29, 2006 WL 288227, at *3 (M.D. Fla. Feb. 6, 2006), which permitted civil penalties in the amount of pecuniary gain, however, I find *Rapoport* controlling.

⁴⁹ The dates are when Sovereign entered into the first referral agreement and the last date in the record of Grossman working with Sovereign.

These filings do not include the December 23, 2008, Form ADV signed by Grossman because the evidence suggests it was intended to be signed by Adams. Div. Ex. 84A; *see supra* p. 8. Two Forms ADV were filed with the Commission on March 23, 2007. For the purposes of imposing civil penalties, I counted these as one filing.

I determine that a third-tier penalty is required considering the willful violations and multiple public interest factors . The case law supports the proposition that violations of the antifraud provisions of the securities statutes merit severe sanctions. *Jose P. Zollino*, Exchange Act Release No. 55107, 2007 WL 98919, at *5 (Jan. 16, 2007); *Marshall E. Melton*, Advisers Act Release No. 2151, 2003 SEC LEXIS 1767, at *29-30 (July 25, 2003). Adams agreed to the imposition of a third-tier civil penalty based on willful violations of Securities Act Section 17(a); Exchange Act Section 15(a); Advisers Act Sections 206(1), 206(2), 206(3) and 207, and that he willfully aided and abetted and caused Sovereign’s violations of Exchange Act Section 15(a) and Advisers Act Section 206(4) and Advisers Act Rules 204-3 and 206(4)-2. *Larry C. Grossman*, 2014 SEC LEXIS 1261, at *27-29. As with Grossman, Adams’s actions caused harm to Sovereign’s clients as many of them lost significant portions of their retirement accounts. Adams was unjustly enriched by \$1,070,828, the amount he received in referral fees for recommending the Battoo Funds to Sovereign’s clients. These mainly antifraud violations committed from October 1, 2008, until at least February 6, 2013, when the Commission canceled Sovereign’s registration, indicate that it is in the public interest to impose a civil penalty to deter Adams and others from future violations. *Larry C. Grossman*, 2014 SEC LEXIS 1261.

I have considered Adams’s willingness to settle the proceeding as a mitigating factor. I have not given any weight to Adams’s alleged inability to pay for two reasons. First, the settlement does not mention an inability to pay defense and second, Adams has not attempted to comply with the Commission’s Rules of Practice on the subject, requiring a sworn financial disclosure statement.⁵⁰ See Rule 630 and Form D-A, 17 C.F.R. § 209.1; see also *Gregory O. Trautman*, Securities Act Release No. 9088, 2009 SEC LEXIS 4173, at *93-94 & n.113, 115 (Dec. 15, 2009); *Terry T. Steen*, Exchange Act Release No. 40055, 1998 SEC LEXIS 1033, at *23 (June 1, 1998) (“Given the respondent’s burden of demonstrating inability to pay, financial information supporting that argument must be presented before the law judge.”).

Second, even if Adams is unable to pay, his violations as an investment adviser are egregious – there were fifteen payments in all that Adams received from Battoo and many retired investors were left badly financially damaged. Div. Motion at 9-10. Therefore, I will order that Adams be assessed a penalty of \$50,000 for each of the fifteen payments Adams received from Battoo for a total of \$750,000.⁵¹

Disgorgement

⁵⁰ Adams’s May 15, 2013, Chapter 7 bankruptcy petition filed in the Middle District of Florida, *In re Gregory James Adams*, Case No. 8:13-bk-6411, and his sworn declaration dated October 13, 2014, and attached to his Opposition to the Division’s Motion for Summary Disposition, describing his financial situation will be matters of record as are the Division’s criticisms of this material. Reply in Support of Motion at 11-12.

⁵¹ The Division in its Motion for Summary Disposition indicated that to the extent the automatic bankruptcy stay remains in effect at the time of the Initial Decision, presumably when the Initial Decision becomes final, the Division would employ bankruptcy procedures to enforce any monetary orders against Adams. Div. Motion at 6 n.3.

Disgorgement of ill-gotten gains “is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws.” *Montford & Co.*, 2014 SEC LEXIS 1529, at *94 (quoting *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989)); *see SEC v. Whittmore*, 659 F.3d 1, 7 (D.C. Cir. 2011). Securities Act Section 8A(e), Exchange Act Section 21C(e), and Advisers Act Section 203(k)(5) authorize disgorgement, including reasonable interest, in cease-and-desist proceedings. 15 U.S.C. §§ 77h-1(e), 78u-3(e), 80b-3(k)(5). Exchange Act Section 21B(e), Investment Company Act Section 9(e), and Advisers Act Section 203(j) authorize disgorgement in proceedings in which a penalty may be imposed under such sections. 15 U.S.C. §§ 78u-2(e), 80a-9(e), 80b-3(j).

“When calculating disgorgement, ‘separating legal from illegal profits exactly may at times be a near-impossible task.’” *Montford & Co. Inc.*, 2014 SEC LEXIS 1529, at *94 (quoting *First City Fin. Corp.*, 890 F.2d at 1231). “As a result, disgorgement ‘need only be a reasonable approximation of profits causally connected to the violation.’” *Id.* (quoting *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995)). “Once the Division shows that the disgorgement is a reasonable approximation, the burden shifts to the respondent to show that the amount of disgorgement is not a reasonable approximation.” *Id.* (citing *SEC v. Happ*, 392 F.3d 12, 32 (1st Cir. 2004)). “The risk of uncertainty in calculating disgorgement should fall on the wrongdoer whose illegal conduct created that uncertainty.” *Id.* (quoting *SEC v. Happ*, 392 F.3d at 31); *SEC v. Platforms Wireless Int’l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010).

As to Grossman: The Division’s disgorgement amount of \$3,407,765.66, plus prejudgment interest, for Grossman is the undisputed amount Grossman received in fees and compensation under the undisclosed referral and international consulting agreements.⁵² Disgorgement of this entire amount is reasonable.

At the hearing, Grossman attempted to introduce evidence that he settled a lawsuit with a payment to a Sovereign investor for \$403,385. Tr. 773-76. The Division objected and I denied the introduction in evidence of a complaint and a wire transfer.⁵³ Tr. 773-76. I issued an order on November 28, 2014, requiring Grossman to file by December 12, 2014, the material that supports the alleged payment of \$403,385 to a Sovereign investor. *Larry C. Grossman*, Admin. Proc. Rulings Release No. 2061, 2014 SEC LEXIS 4517. On December 5, 2014, Grossman filed (1) the American Arbitration Association, Inc., Statement of Claim in the matter of *DePasquale v. Sovereign International Asset Management* with Exhibits A-E; (2) a sheet which shows withdrawals for wire transfers to Lillian DePasquale and Anthony M. Abraham, Esq., totaling \$403,585.01, with the handwritten statement “\$403,385 – DePasquale settlement payment”; and (3) a copy of a check from Grossman to the IRS for \$1,373,289.47.

⁵² Grossman did not challenge the accuracy of Strandell’s calculations of these amounts at the hearing as he chose not to cross-examine Strandell. Tr. 617.

⁵³ The Division contends that Grossman failed to plead set-off, offset, or any comparable position as an affirmative defense pursuant to Rule 220(c), and thus waived the right to argue for such a reduction.

I reject Grossman's attempt to reduce this amount by an IRS payment he made. Disgorgement may not be offset by tax liability owed to the IRS. *SEC v. U.S. Pension Trust Corp.*, 444 F. App'x 435, 437 (11th Cir. 2011); *SEC v. Razmilovic*, 822 F. Supp. 2d 234, 277 (E.D.N.Y. 2011), *aff'd in part, vacated in part on other grounds, remanded*, 738 F.3d 14 (2d Cir. 2013); *SEC v. Koenig*, 532 F. Supp. 2d 987, 994 (N.D. Ill. 2007). Based on Grossman's late filed submission, which I will allow into evidence as Respondent Exhibit 91, I will reduce the Division's disgorgement amount of \$3,407,765.66, by \$403,585.01. Given the facts and circumstances, I find \$3,004,180.65, plus prejudgment interest to be a reasonable disgorgement amount as to Grossman.

As to Adams: The disgorgement amount of \$1,070,828, the amounts Adams received in fees and compensation under the referral and international consulting agreements, plus prejudgment interest, is a reasonable approximation of the amounts received by Adams. I decline to reduce it. I reject Adams's arguments that the amounts should be reduced to account for legitimate business expenses and payments made to Grossman.⁵⁴ See *SEC v. Merchant Capital, LLC*, 486 F. App'x 93, 96 (11th Cir. 2012) ("[T]he overwhelming weight of authority holds that securities law violators may not offset their disgorgement liability with business expenses." (citation omitted)); *SEC v. Whittemore*, 744 F. Supp. 2d 1, 9-10 (D.D.C. 2010), *aff'd*, 659 F.3d 1 (D.C. Cir. 2011) (finding that a payment made from one defendant to another is irrelevant in calculating disgorgement); *SEC v. Aerokinetic Energy Corp.*, 444 F. App'x 382, 385 (11th Cir. 2011) ("[T]he cases overwhelmingly hold that '[h]ow a defendant chooses to spend his ill-gotten gains, whether it be for business expenses, personal use, or otherwise, is immaterial to disgorgement.'" (internal citation omitted)).

Industry Bars

The Division requests that Grossman be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization (collectively, industry bar), as well as a prohibition 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 (collectively, officer director bar). Div. Br. at 65. Grossman's brief does not directly address the subject.

Exchange Act Section 15(b) and Advisers Act Section 203(f) are similar. Both authorize an industry bar if such person was associated with an investment adviser or broker-dealer at the time of the alleged misconduct; such sanction is in the public interest; and such person (1) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission; or (2) has willfully violated, or willfully aided and abetted violations of, certain provisions of the securities laws. 15 U.S.C. §§ 78o(b)(4)(A), (D), (E), 80b-3(f), (e)(1), (5), (6); see *John W. Lawton*, Advisers Act Release No. 3513, 2012 SEC LEXIS 3855, at *25 n.30, *38 (Dec. 13, 2012).

⁵⁴ The documents Adams attached to his sworn declaration dated October 13, 2014, will be matters of record.

Investment Company Act Section 9(b) authorizes an officer director bar if such sanction is in the public interest and such person has willfully violated or willfully aided and abetted violations of certain provisions of the securities laws. 15 U.S.C. § 80a-9(b)(2), (3).

The cited statutory provisions are applicable based on findings that Grossman was associated with an investment adviser and that he acted as an investment adviser and broker dealer while violating, aiding and abetting, and causing violations of the Securities Act, Advisers Act, and Exchange Act. The question then becomes whether imposition of an industry bar and officer irector bar is in the public interest.

In determining whether sanctions are in the public interest, the Commission considers the *Steadman* factors: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; the likelihood that the respondent's occupation will present opportunities for future violations; and deterrence. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *Montford & Co. Inc.*, 2014 SEC LEXIS 1529, at *77; *see Schield Mgmt. Co.*, Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35-36 & n.46 (Jan. 31, 2006).

Grossman's violations were egregious, recurrent, and involved deliberate actions undertaken with scienter to achieve financial gain. Grossman took advantage of inexperienced investors and used his reputation as an expert in offshore investments to recommend investments to Sovereign clients for which he received undisclosed referral and consulting fees totaling more than \$3.4 million. Additionally, Grossman did not perform adequate due diligence on these investments and when red flags arose, he ignored them, resulting in substantial losses to Sovereign clients. Investment advisers have an "affirmative duty of utmost good faith, and full and fair disclosure of all material facts." *Capital Gains Research Bureau*, 375 U.S. at 194 (internal quotation marks omitted). Grossman's testimony at the hearing and the testimony of the customers who dealt with him showed him to be charming, with considerable verbal skills and self-confidence that allowed him to convince numerous investors that he was a knowledgeable person who would give their retirement funds his individual attention. Richards testified that Grossman was very convincing that he was an honest, talented person. Grossman offered no plausible reasons for his dastardly actions and has shown no remorse.

Applying the *Steadman* factors and considering the need to deter others from similar misconduct, it is in the public interest to bar Grossman from participation in the securities industry to the maximum extent allowable. "Because the securities industry presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence, it is essential that the highest ethical standards prevail in every facet of the securities industry." *Donald L. Koch*, 2014 SEC LEXIS 1684, at *86 (internal quotation marks omitted).

Cease and desist

Securities Act Section 8A, Exchange Act Section 21C, and Advisers Act Section 203(k) authorize the Commission to issue a cease-and-desist order against any person who has violated

the Securities Act, Exchange Act, or Advisers Act, respectively, or any rule or regulation thereunder; or against any person who caused the violation due to an act or omission the person knew or should have known would contribute to such violation. 15 U.S.C. §§ 77h-1(a), 78u-3(a), 80b-3(k)(1).

In determining whether to issue a cease-and-desist order, the Commission considers essentially the same factors as in *Steadman*; although there must be some likelihood of future violations whenever the Commission issues a cease-and-desist order, the required showing is “significantly less than that required for an injunction.” *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 SEC LEXIS 98, at *101, *114 *116 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002). Absent evidence to the contrary, a single past violation ordinarily suffices to establish a risk of future violations. *Id.* at *102-03, *114-15 & n.147. In addition, the Commission considers “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 *116. The Commission weighs these factors in light of the entire record, and no one factor is dispositive. *Id.*; *accord Montford & Co.*, 2014 SEC LEXIS 1529, at *88.

As noted, the *Steadman* factors weigh heavily in favor of sanctions. In addition, the testimony of five Sovereign investors attests to a high degree of harm caused by Grossman. Davidson lost almost \$700,000 in Anchor A and almost \$800,000 in Anchor C. Div. Ex. 50 at 6-9; Div. Ex. 50Q. Montes invested \$109,600 of her IRA with Sovereign and has not been able to recover any of it. Tr. 165; Resp. Ex. 108. Richards invested \$161,777 in Anchor A and Anchor C and has been unable to recover any of it. Dp. 111, 146-47; Dp. Exs. 10, 21. Van Dyke, who estimated losses of \$1,050,000 due to her investment in Anchor A, and a total of \$1.2 million as a result of her relationship with Grossman and Sovereign, settled her lawsuit with Sovereign and Grossman for an undisclosed amount. Tr. 86, 88-89. Gilluly invested about \$139,000 with Sovereign and was unable to redeem \$156,000 from his account as of May 2011. Tr. 527, 556-57.

Along with the other measures that result from this proceeding, a cease-and-desist order is needed to serve the public interest by eliminating the possibility that Grossman will be able to engage in future misconduct.

Fair Funds

Pursuant to Commission Rule of Practice 1100, 17 C.F.R. § 201.1100, I will require that the amount of disgorgement, prejudgment interest, and civil money penalties be used to create a Fair Fund for the benefit of Sovereign International Asset Management’s clients harmed by the violations.

Record Certification

Pursuant to Commission Rule of Practice 351(b), 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, 2014.

Order

I ORDER that, pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Section 203(k) of the Investment Advisers Act of 1940:

Larry C. Grossman, shall cease and desist from committing or causing violations, and any future violations, of Section 17(a) of the Securities Act of 1933; Section 15(a) of the Securities Exchange Act of 1934; and Sections 204, 206(1), 206(2), 206(3), 206(4), and 207 of the Investment Advisers Act of 1940 and Advisers Act Rules 204-3 and 206(4)-2.

I FURTHER ORDER that, pursuant to Section 8A(e) of the Securities Act of 1933, Section 21B(e) and 21C(e) of the Securities Exchange Act of 1934, Sections 203(j) and 203(k)(5) of the Investment Advisers Act of 1934, and Section 9(e) of the Investment Company Act of 1940:

Larry C. Grossman shall disgorge \$3,004,180.65, plus prejudgment interest; and

Gregory J. Adams shall disgorge \$1,070,828, plus prejudgment interest.

Prejudgment interest shall be calculated at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), shall be compounded quarterly, and shall run from November 1, 2008, for Grossman and from September 1, 2010, for Adams, through the last day of the month preceding the month in which payment is made.⁵⁵ 17 C.F.R. § 201.600.

I FURTHER ORDER that, pursuant to Section 8A(g) of the Securities Act of 1933, Section 21B(a) of the Securities Exchange Act of 1934, and Section 203(i) of the Investment Advisers Act of 1940:

Larry C. Grossman shall pay a civil monetary penalty in the amount of \$1,550,000; and

Gregory J. Adams shall pay a civil monetary penalty in the amount of \$750,000.

⁵⁵ Grossman received the funds in the Jyske account through October 1, 2008, when he sold Sovereign. Strandell found that Adams received the last payment from the account on August 31, 2010. Div. Motion, Ex. A at 2.

I FURTHER ORDER that, pursuant to 17 C.F.R. § 201.1100, any funds recovered by way of disgorgement, prejudgment interest, or penalties shall be placed in a Fair Fund for the benefit of investors harmed by the violations.

I FURTHER ORDER that, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940:

Larry C. Grossman is permanently barred from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, 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.

I FURTHER ORDER the following documents admitted into evidence: the attachments to the Division of Enforcement's Motion for Summary Disposition Against Respondent Gregory J. Adams; Exhibit 1 attached to Gregory J. Adams's Opposition to the Division's Motion for Summary Disposition; and Respondent Exhibit 91, consisting of the three documents filed by Grossman on December 5, 2014.

Payment of disgorgement, prejudgment interest, and civil penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or (3) by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying the Respondent(s) and Administrative Proceeding No. 3-15617, shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Bld., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a 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 a motion to correct a 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.

Brenda P. Murray
Chief Administrative Law Judge