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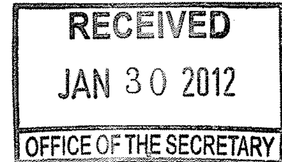
Before the
SECURITIES EXCHANGE COMMISSION



In the Matter of MICHAEL R. PELOSI, Respondent.	Administrative Proceeding File No. 3-14194

RESPONDENT MICHAEL R. PELOSI'S PETITION FOR APPEAL OF INITIAL DECISION

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Pursuant to R. 410 of the Rules of Practice of the Securities Exchange Commission ("SEC" or "the Commission"), Respondent Michael R. Pelosi ("Respondent" or "Pelosi"), by and through his attorneys, McCarter & English, LLP (John R. Hewitt, appearing), moves to appeal the January 5, 2012, Initial Decision of the Administrative Law Judge ("Decision") in this matter.

FINDINGS AND CONCLUSIONS OF THE INITIAL DECISION AS TO WHICH EXCEPTION IS TAKEN

The Respondent maintains that the Decision embodies findings and conclusions of material fact that are clearly erroneous and conclusions of law that are erroneous. Initially, this Petition will address those material factual errors contained in the Discussion and Analysis section and then review several material factual errors that have a significant effect on the entire Decision. The Respondent will then address the errors in the Conclusions of Law.

Decision Discussion and Analysis

The Respondent will review below the Discussion and Analysis section of the Decision, noting those material factual errors that exist in these.

Missing Letters

In this section, the Decision confuses issues, i.e., missing letters and unsigned letters. In this argument, proportion (in this case frequency) is a determination of statistical relevance, and therefore these letters must be considered. The Division's forensic expert testified that it was his understanding that these were not all the letters that Pelosi produced, but rather were the letters that were available (TR 462 6-13).[1] Additionally, the Decision states that all the letters were produced by Pelosi, but this is completely erroneous as Pelosi never had possession of any client letters. It was Halsey, not Pelosi, that produced the documents and it was Halsey, not Pelosi, who failed to properly retain many of them.

The Decision also notes that "Thus, while Pelosi may have been at the firm for a sufficient duration to send 500 client letters, the number of letters actually sent was smaller given his many client meetings" Based on this argument, and given the 243 letters in the Division analysis, Pelosi would have to have had 257 client meetings in the approximate 36 months while he was at Halsey. This is highly improbable, given that Halsey only had three portfolio managers to handle more than 700 accounts. Moreover, Halsey did not produce the PowerPoint presentations that would have been prepared for these meetings, if, in fact, these meetings took place. Respondent's Exhibit 4 already includes and identifies all the PowerPoint presentations that were made available in the production.

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[1] Citations to the hearing transcript are noted as "TR __ " Citations to Exhibits are noted as "Division Exh. ____" or "Resp. Exh. ___". Citations to Respondent Post Trial Brief and other briefs are identified by abbreviation and page. The Initial Decision is noted as Decision at p. __.

The Decision also notes that the "The Division did not include in its analysis Pelosi's unsigned letters". This is an inaccurate statement as their analysis included 25 unsigned letters, which contained 45 performance results (some letters contain both quarterly and annual results). Each of these 45 instances contained data that appears unfavorable to Pelosi (i.e., demonstrated inflations compared to current Advent reports). Yet, the Division chose to exclude every unsigned letter, or 84 instances, that resulted in no difference or a deflation. These were discussed on p. 7 of the Respondent's Reply brief and listed in an attachment to it. Contrary to the Decision's conclusion on p. 12, these unsigned letters have been submitted into evidence, as they are included on Respondent's Exhibit 4, a summary exhibit containing all this information that was admitted into evidence at the hearing. Therefore, the Division's inconsistent treatment of the unsigned letters and the Decision's failure to address this are material factual errors.

Pelosi Justifications

In this section, the Decision concludes that Halsey's price information and performance results were generally accurate and that Pelosi never complained to anyone at Halsey about the accuracy of the data. As to the complaints, Mr. Pelosi testified that he complained numerous times before and after the Data Exchange conversion. Further, the Decision notes on p. 13 that Mr. Pelosi did complain to Mr. Zoldy:

> Pelosi perceived Halsey as possessing subpar valuation procedures and antiquated systems, and engaging in inaccurate manual pricing. Resp. Br. 8. Therefore, he reviewed the Axys performance numbers, finding what he perceived as certain inaccuracies in the report's performance numbers, which he manually corrected. Id. For example, while writing his first few client letters, Pelosi testified that he found illogically large performance numbers; Pelosi went to Zoldy who said "I can't explain it. It is what it is. This is the system." Tr. 1205-06. While Zoldy never told him to manually calculate performance Pelosi realized he needed to take more ownership of performance results. Tr. 1208.

Yet, later on the same page the Decision notes:

> Also, Pelosi never complained to anyone at Halsey about the accuracy of the Axys data or its reports.

In fact, Mr. Pelosi repeatedly confronted Mr. Zoldy with data concerns and, as noted above, was told by Mr. Zoldy that he "couldn't explain it. It is what it is".

Data Inaccuracies

- Pricing and Reconciliation: The Decision again confuses issues, i.e. reconciliation and pricing. Pelosi's assistant, Sue Frois ("Frois") testified that reconciliation

involves much more than pricing, as it involves various processes. TR .943:1-944:8. Ms. Frois testified that there were often reconciliation adjustments that had to made after the fact. TR 854:3-13. The pricing issue relates to bonds, and Pelosi, Frois and Zoldy all testified that Zoldy would change the price file every month and key in Bob Sharkey's prices. Zoldy further admitted that this was a conflict of interest since he was using prices from the same person that sold him the bonds. TR 837:23-24, 416:5-11, TR933:1-4, 932:19-933-4

- Question Marks: The Decision states in this section that Halsey's employees provided several reasons for the question marks. However, Ms. Frois testified that a question mark means that there is something wrong with the particular line item and that the performance numbers on that report are not valid. (TR 847-848) Rourke admits that inaccurate data in the Advent system led to ? appearing on the recently produced Advent reports which were included in Halsey's production of documents (TR 69: 2-9). As a general rule, if a report generated at the end of a month had a question mark, it would be investigated and corrected. However, Halsey provided numerous reports with question marks that were generated in 2009, and those reports are compared against Pelosi letters in the Divison's analysis, which serves as evidence that Advent data changes over time. It is therefore impossible to know exactly what a manager was looking at several years earlier. (Respondent's Post-Hearing Brief at p. 22 and Respondent's Exhibit 26).

- "N/A and "0" Entries - Numerous Advent reports containing "N/A" and "0" dated in 2009 were included in the Division production and ultimately in its analysis (Respondent Exhibits 4, 6, 26 and 27). This clearly evidences that the manual entries into the Halsey's system lead to continual errors in it. This, among other things, led Pelosi to question the accuracy of the system.

- Replaces old data – As noted above, the Respondent provided a series of examples that clearly evidenced that Halsey's system was incapable of updating the numerical entries in the system while at the same time retaining the replaced numbers. (Respondents Post Trail Brief at p. 22 and Exhibit 27)

In summary, the Respondent, as noted above, provided numerous examples of entry errors, reconciliation issues and recordkeeping problems that lead Pelosi to have serious concerns about Halsey's system and were highly relevant to the Data Inaccuracies section of the Decision. The failures to consider these properly in the Decision lead to these findings of material fact that were clearly erroneous.

DCF Reports

Pelosi's testimony and Post Hearing Brief provide a thorough and accurate account of his use of the DCF reports (Respondent's Reply Brief p. 13). Zoldy and Julian admitted that DCF reports were given to Pelosi and Julian acknowledged that they provided greater transparency than TWR and were given to investigate questionable returns as a result of cash flow issues that would arise as Halsey did not reconcile or price daily or even monthly on some accounts. TR 482:20-25. Pelosi would use the DCF in certain instances because it was a "point to point" methodology and avoided that problem. Exhibit 4 demonstrates the many instances in which Pelosi used the DCF report.

Cash Flow and Deitz

Pelosi does not state that TWR reports do not take capital flows into account. He is therefore not contradicted by his own expert witness and has testified to the opposite - that the TWR report was extremely sensitive to cash flows because Halsey did not price or reconcile daily or monthly. Julian acknowledged as much: TR 482: 20-25. Without daily or even monthly pricing and reconciliations, the TWR report is prone to inaccuracies as a result of capital flows. Division's Exhibit 11 addresses the TWR methodology's sensitivity to cash flows and recommended a technique to arrive at a time weighted return, however, no evidence has been provided by the Division that Halsey ever made such calculations. (This is extensively discussed in Respondent's Post Trial Brief at p. 11-15). Pelosi has provided more than a dozen references in Exhibit 4 to differences in specific letters attributable his Dietz calculation and testified to many of such calculations in great detail. 1051:22 – 1071:1; TR 1157:18-1159 TR 1169:19-1170:6; 1173:8-1174:7; 1174:23 – 1175:10; 1178:2- 1178-17.

Reporting for Atypical Periods

The Decision concludes that Pelosi's odd period reporting are not valid because they were not TWR based. However, none of Haley's TWR based reporting were appropriately time weighted or complied with GIPS requirements, as they did not price often enough. This is the very reason that Pelosi felt the need to make manual adjustments for these periods. It is important to note that the instructions on TWR that Halsey provided were from the Help function of the current version of Advent that they subscribe to, evidenced by the 2009 date on Division Exhibit 11. Halsey did not upgrade to this version of Advent until 2008, and was not in place for the majority of the time that Pelosi was at Halsey. The earlier Advent system could not perform the calculations described in that document because Halsey didn't price daily before the upgrade and only reconciled quarterly after it.

Preferred Stock Dividend

Mr. Pelosi reported performance of preferred stocks by accrual accounting vs. cash accounting which is a recognized and appropriate reporting adjustment in accordance with AIMR (later CFA Institute) Standards and GIPS standards and was fully consistent to his reporting responsibilities. (Respondents Exh. 29). Mr. Pelosi testified that ha was not able to provide reconciliations for these adjustments, as the information necessary to perform such calculations should be in the data portion of the Advent system and, as noted above, Halsey did not maintain transaction histories for any client or any time period. While the Division had claimed that Pelosi's adjustments were unbelievable, they provided no record of preferred stock returns quoted in Pelosi letters compared to any type of Advent performance report upon which to base their claim.

Combining Assets

As noted in testimony, combining like asset returns in order to provide a complete asset class view has no bearing on the total portfolio returns. Pelosi simply explained these combinations in response to a question from the Division in an effort to provide a complete explanation of this situation: "this is not, I suppose an actual adjustment of performance, but I did make calculations to aggregate the returns of similar asset classes" TR 647:11-15.

Bond Prices

Pelosi never suggested that he used different bond prices than the ones Zoldy obtained, in fact he states the opposite of this in his testimony. TR 672:10-18, 659. Pelosi does not allege that he used Schwab prices for bonds but rather he indicates that he did not understand the process by which Halsey would over ride Schwab values and assign new values. TR 673:2-673:6.

Template Errors

The Decision finds that Pelosi's evidence regarding a specific example of a template error is not credible because he updated some, but not all, the data in the chart in his example of a 1/31/08 letter to Lonergan. The fact that not all of the data was updated is the very point that Pelosi is demonstrating: that existing letters were used as templates for others and mistakes were made when typing over numbers. Some, but not all, of the correct data would be entered. It is evident in his example that some, but not all of the data was changed as the matching data in the chart is located in the exact same position in the charts of the two letters. In fact, some of the template errors in Respondent's Exhibit 25 demonstrate errors in which entire charts were copied.

Each of the sub-sections in this section, Pelosi's Justifications, in the Decision contains one or more clearly erroneous material factual findings that each provides a sound basis for granting this petition.

Clearly Erroneous Material Factual Findings That Have a Significant Effect on the Entire Decision

Halsey's Lack of Required Compliance Procedures

The Decision finds that "while Halsey's written compliance manual did not have anything on reconciliation nor much on pricing, Mr. Julian testified Halsey still had formal operations procedures."[2] Much of the Decision is based on this finding as, without it, there can be no claim that Mr. Pelosi violated this procedure in the drafting of his letters. Actually, this statement has no basis in fact as no other proof of any such procedures was ever produced by the Division at trial. Julian, Zoldy, Rourke and Rynne all testified that certain information was provided to Pelosi each month and that somehow, there was a general understanding about the use of certain reports. But nothing was ever established by the Division that proves Halsey had any actual compliance or "operational" procedures in place. In fact, Halsey had no procedures whatsoever in place for reconciliation, pricing or even for drafting client correspondence. This failure constitutes not only a violation of Rule 206(4)-7 of the Investors Act of 1940, but resulted in no clear direction or procedure for Pelosi to follow in constructing his client letters. It was Julian's responsibility, as the Chief Compliance Officer, to ensure that the firm had such procedures. This procedural failure is definitively evidenced in the supposed training of Pelosi, which only involved a brief one-time informal session with each principal. In fact, Halsey had:

No formal written procedures regarding client correspondence, pricing or reconciliation;

No formal training for client correspondence, pricing or reconciliation;

No review-formal or informal-of client correspondence; and

No formal record keeping procedures for client correspondence.

Additionally, Pelosi had never before written such client correspondence and neither Julian nor Zoldy ever even inquired about this. Further, in the period from his initial employment in April 2005 to August 2008, no one at Halsey, including Julian and Zoldy, ever reviewed any of Mr. Pelosi's client correspondence. There was one exception to this. Mr. Pelosi shared certain clients with Julian and Zoldy, and, in that case, each PM was to review the client letter for accuracy, content, etc. Whether or not these reviews were regularly conducted by Julian or Zoldy remains a question, but there is no question that nothing was ever conveyed to Pelosi regarding them. Further, in the entire three year period of his employment, neither Julian nor Zoldy ever said anything to Pelosi about the content of the letters that he drafted. The requirement for such procedures is not some regulatory nicety, but one of the fundamental requirements under the Advisers Act. Without it, there would be no consistency in client communications, no records maintained, etc. In fact, this is exactly what happened at Halsey,

[2] Decision at p. 9.

and the failure to address it properly in the Decision is a clearly material factual error in the findings in the Decision.[3]

Halsey, with Julian and Zoldy as principals, was examined by the SEC Office of Compliance and Inspections from October 19, 2009 to January 29, 2011. The review period in the examination covered the time that Mr. Pelosi was employed at Halsey. The SEC found that their systems were in violation of Rule 206(4)-7 in the exact areas in which Mr. Pelosi had registered concern:

> Halsey also lacks standard operating procedures in two areas; reconciliation and portfolio management. The staff believes that the firm should adopt written procedures documenting its processes of reconciling client account assets with custodial records as reflected in the firm's Advent system. The staff also believes that the firm should adopt written procedures documenting client reviews, meetings, and changes to client guidelines.
>
> Failure to know and follow adopted policies and procedures, and failure to adopt policies and procedures that reflect all critical elements of the advisory business is inconsistent with the requirements of Rule 206(4)-7.
>
> OCIE also found the following in its audit:
>
> *Total Return Composite*
>
> *Inaccurate and Prohibited Disclosure*
>
> Halsey's composite is entitled *Total Return Composite,* and the disclosures state "Our Balanced Account Composite performance is calculated according to methods prescribed by the Association for Investment and Research (AIMR)." AIMR is now known as the CFA Institute, and what used to be referred to as AIMR standards are now referred to as GIPS standards (Global Investment Performance Standards). Halsey's Compliance Manual states and management confirmed to the staff that the firm is not GIPS compliant Moreover, the CFA Institute's website states: "Statements referring to the calculation methodology used in a presentation as being 'in accordance (or compliance) with the Global Investment Performance Standards' are prohibited."
>
> An inaccurate claim of GIPS compliance may constitute a false and misleading statement under Rule 206(4)-1 (a)(5).
>
> *Inaccurate Composite*
>
> Halsey lacks written policies and procedures for the construction and maintenance of its composite. The staff's review of client accounts identified 68 accounts that appeared to meet the criteria to be included in the composite but were not. Halsey's review of those accounts identified six that should have been included in the composite. Management explanations for the exclusion of the remaining 62 accounts from the composite included: limitations on their

3 Resp. Post Trial Brief at p. 3-8

> discretion for selecting securities; accounts were a subset of larger family relationships; and the clients' investment objectives were not consistent with the composite.
>
> Halsey should review all client accounts to ensure the composite is accurately prepared and adopt written policies and procedures for its construction and maintenance.

Finally, OCIE found the following about the CCO, Mr. Julian:

> Halsey's CCO had never conducted the annual review of Halsey's compliance policy and procedures that is required by Rule 206(4)-7(b).[4]

The Decision states the following regarding the OCIE letter:

> The Staff also noted that Halsey disclosed that it calculated performance consistent with the Association for Investment and Research, but these standards are now called Global Investment Performance Standards (GIPS). Resp. Ex. 18; Tr. 314. Overall, the Staff did not find that, outside of Pelosi's misconduct, Halsey misreported performance information. Tr. 312; Resp. Ex. 18.[5]

This commentary completely misinterprets the OCIE commentary noted above, which is specifically identified in the OCIE letter as a deficiency based upon their examination, and its significance is disregarded in the Decision. By any reading or assessment, the above OCIE commentary is a stern warning to Halsey, Zoldy and Julian to correct these very serious problems, several of which have a direct bearing on this matter. Disregarding these most serious of compliance issues in the Decision is yet another instance of a clearly material factual error in the findings in the Decision.[6]

Pelosi Discussions with Kathleen Rourke and Maureen Rynne Regarding Performance Adjustments

Two Halsey portfolio assistants, Kathleen Rourke ("Rourke") and Maureen Rynne ("Rynne"), each had separate conversations with Mr. Pelosi in 2008 regarding his adjustments to the performance figures in his Client Letters and/or PowerPoints. In each case, the assistant was preparing PowerPoint presentations for Mr. Pelosi's clients and noticed that some of the figures that they were using in the PowerPoint were different than those in the Halsey system.

In late 2007 or early 2008, Ms. Rourke inquired with Mr. Pelosi about this, and he responded that he had a different way of calculating the performance figures.[7] Ms. Rynne also noticed in this time period the difference in performance numbers when she was preparing a

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[4] Resp. Exh. 18.

[5] Decision at p. 8.

[6] Another significant fact that is not addressed properly in the Decision is Halsey and Julian's filing of a false Form U-5 upon Pelosi's termination. Resp. Post Trail Brief at p. 21.

[7] TR 39:1-3.

PowerPoint presentation for Mr. Pelosi and, in response to her inquiry, he responded that "he used a different calculation".[8]

In these discussions, Mr. Pelosi responded without any hesitation and did not instruct Ms. Rourke or Ms. Rynne to conceal his actions or to refrain from speaking to anyone about them. For a substantial period before he was confronted by Mr. Zoldy and Mr. Julian, Mr. Pelosi was then openly making these adjustments to his clients' performance figures and readily discussed them with two assistants that worked with him. This unquestionably evidences that his intention in these adjustments was to assist his clients in having a better understanding of their portfolio information, and this conforms with all regulatory requirements. While this situation is noted in the Decision[9], its significance is completely ignored and is another in a series of clearly material factual errors in the findings in the Decision.

Pelosi Lack of Motive

The Decision does not definitively address one of the most important issues in this case; motive. There is good reason-Pelosi had no motive. Throughout his career, Pelosi has experienced continual success in his advisory business and has been progressively given greater responsibilities in his fifteen (15) year career. Pelosi's first full-time position was as a credit analyst at Bank of Boston ("BB"), where as a portfolio manager he managed approximately $100 million in assets for approximately 80 clients. In the early 1990's, Pelosi received a series of promotions, advancing to become a Senior Portfolio Manager and managing several hundred million dollars in assets for over 200 clients. He was named a Senior Vice President at BB in the late 1990's, and, at that point, was managing over $ 350 million in assets.

BB was acquired by Fleet Bank ("Fleet") in 1999, and, in addition to the above responsibilities, was also made Co-Head of the Columbia Large Cap Core Equity Team and a Senior Vice President. The Bank of America ("BA") acquired Fleet in 2003, and, after this acquisition, Pelosi, in addition to his existing duties, was asked to manage one of BA's largest equity funds-the National Strategic Growth Fund. At this point, Pelosi was managing over $2 billion in assets.

After assuming a senior role at BA, Pelosi was regularly approached to relocate to New York or Boston, and to relinquish his individual advisory work so as to focus more on his other responsibilities. However, Pelosi desired to remain in his hometown, and was reluctant to relinquish his individual advisory work as he valued and thoroughly enjoyed it. After extensive consideration, Pelosi determined that he did not desire to move, or to give up his individual advisory relationships. As a result, he began a discrete review of possible employment opportunities in the Central Connecticut area, and, accepted an offer to be a portfolio manager at Halsey.[10]

While at Halsey, Pelosi continued his exemplary performance that resulted in the securing of many of his former clients which substantially expanded Halsey's assets under management. Pelosi was successful in bringing 26 of his former relationships into Halsey with

[8] TR 124:17-21.
[9] Decision at p. 5.
[10] TR 605 to 606 and 1006 to 1035.

over $66,000,000 in assets.[11] Pelosi's clients continued to experience genuine success with Pelosi at Halsey.[12] Pelosi then had no reason to alter performance data and therefore no motive to improve his performance reporting.

Pelosi's lack of motive is also, ironically, supported by the claims of the Division. The changes that are attributed to Pelosi are described as follows by the Division:

> In comparing Pelosi's account reporting to TWR Reports, the Division also presented evidence summarizing the sizes of Pelosi's inflation of performance. This analysis displayed the number of instances of inflation according to ranges of basis point size. For Pelosi's reporting of annual account results, this analysis showed there were 50 instances of inflation greater than or equal to 100 basis points, 67 instances of inflation between 50 and 99 basis points, 48 instances of inflation between 25 and 49 basis points, 44 instances of inflation between 10 and 24 basis points, and 39 instances of inflation between 1 and 9 basis points. SoF, ¶ 107.
>
> For Pelosi's reporting of quarterly account results, the analysis showed there were 40 instances of inflation greater than or equal to 100 basis points, 39 instances of inflation between 50 and 99 basis points, 44 instances of inflation between 25 and 49 basis points, 53 instances of inflation between 10 and 24 basis points, and 38 instances of inflation between 1 and 9 basis points. SoF, ¶ 108.

Assuming arguendo the accuracy of this information, there is no sense in Pelosi making such changes, if the reason was to mislead. Why? 100 basis points is, of course, 1%. Virtually, all of the changes were under this percentage. The Division actually notes changes of from 1 to 9 basis points. Practically speaking, these changes have little or no significance in terms of actual increase in numerical value and, in turn, performance. In other words, if Pelosi intended to commit fraud, what sense would it make for him to do so in such an inconsequential manner?

Viewing this from a different perspective, if Pelosi were truly intent on deceiving a client on their portfolio's performance, his method was seriously flawed, as not only were the changes minimal but the account information in the other documents that were provided to Halsey clients in additional to the client letter, i.e., the appraisal report, the account summary, the Schwab monthly account statement and the on-line Schwab account information, were never adjusted by him. Practically speaking, these are the most frequently viewed sources for laymen to determine portfolio performance.[13] Schwab's on-line account statements contained real time detailed portfolio information including the quantity of the security held, the current dollar market worth, the current quote, the change in dollar value per share, the original cost basis, the actual dollar gain/loss and the actual percentage gain/loss. Schwab's account information also provided the market worth, the cost basis, gain/loss and percentage of gain/loss for the total portfolio.

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[11] TR 1038:11-25, 1042:4-20.

[12] TR 1094:4-10.

[13] TR 1427:23-1429:8.

Each client then could see at any time his/her percentage gain/loss on a real time basis per each security in their portfolio as well as their total portfolio percentage return. This then could be directly compared to the performance information in the Client Letter which was also based on a percentage return. While the DCF calculation was a somewhat different assessment, any material adjustment to it that was inconsistent with the Schwab percentages would be immediately apparent.

Further, if Pelosi was intent on a fraudulent design, he allowed the only evidence of this - his Client Letters - to exist untouched in Halsey's records for years.[14] This was true even after he had the discussions with Rourke and Rynne about his use of alternative calculations. (Remember, Halsey had no procedural requirements to retain these letters.) Further, his open and candid response to their questions and his continuation in this practice after these discussions are further evidence of his lack of motive and, also, scienter.

Finally, there was no financial motivation in these adjustments. Neither Pelosi's salary nor profit sharing was dependent on the performance numbers provided in the Client Letters, and the fees that his clients paid were never affected.[15] Finally, as Pelosi's clients had done well for decades under his investment counseling at BA, its predecessors and at Halsey, there was no need for any improper alteration of their performance figures.[16]

The above evidence establishes that there was no reason for Pelosi to deceive his clients, and thus he had no motive. While all of this information was placed into evidence and thoroughly briefed, it was virtually ignored in the Decision. This represents another clearly material factual error in the findings in the Decision.

Conclusions of Law

Misrepresentation

The Decision found that Pelosi "clearly misrepresented portfolio returns to clients." In reaching this conclusion, the Decision first noted that "[t]he Division introduced extensive evidence demonstrating the disparity between the returns Pelosi reported to his clients and the corresponding returns generated by Axys." Thereafter, the Decision noted that, although Pelosi's clients received account appraisals from Charles Schwab and could electronically access their accounts at any time via Schwab, "the portfolio appraisals and Schwab monthly statements only provided clients with their portfolio's market values, not a calculation of the portfolio's return. Nor is there any documentary evidence of what account information Schwab reported in the online statement." Decision at 22.

In reaching this conclusion, the Decision fails to address appropriately that this "disparity" rarely exceeded 1% and, for the main, was under this. It also fails to include the total lack of motive and the absence of any design to deceive, such as was apparent in In re Merrimac Advisors Co., et al, Investment Advisors Act of 1940 Release No. 1977, Investment Company

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[14] Halsey had no procedural requirements to retain these letters.

[15] TR 619:17-620:4

[16] Pelosi TR 1094:4-10, Sciana TR 1400:9-16: 1406:6-7; Bosco TR1432:1-8 and Platano TR 1453:4-7.

Act of 1940 Release No. 25195, 2001 SEC LEXIS 2007 (Sept. 27, 2001) and In re Stan D. Kiefer Assoc., et al, Investment Advisors Act of 1940 Release No. 2023, 2002 SEC LEXIS 723 at *5 (March 22, 2002). Even if the Schwab statements lacked return calculations, and even if the electronic data was not available as documentary evidence, the factual findings do not refute the ready availability of a significant amount of independent account information. A finding that Pelosi sought to deceive his clients, even as he knew this information was well within their reach, strains credulity.

The Decision's finding as to the Division's proof of disparity between the Axys reports and Pelosi's reported results also ignores Halsey's lack of written procedures for the reporting client results. In the absence of written guidelines and anything other than the most rudimentary instruction in Halsey's reporting procedures, Pelosi had no reason to think that his own method of reporting, as opposed to reports generated by Axys, would constitute misrepresentation. Thus, that disparity does not prove misrepresentation and this conclusion of law is erroneous.

Scienter

Scienter is a "mental state embracing the intent to deceive, manipulate, or defraud." Decision at 22. Scienter requires at least recklessness, which in this context means "an extreme departure from the standards of ordinary care. . .to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." Id. (internal citations omitted). In reaching his conclusion as to scienter, the Decision makes much of Pelosi's emotional reaction when Julian and Zoldy confronted him. However, Pelosi's reaction could have reflected anxiety and confusion just as easily as the "guilty state of mind" that the Decision reads into it. Id. at 23. Thus, Pelosi's emotional reaction and expressions of feelings have little to no evidentiary value in establishing scienter.

The Decision also characterizes Pelosi's conduct as "a highly unreasonable departure from the ordinary standard [of care]." However, Pelosi's method of calculation was a well-established one. In the absence of a clearly-defined Halsey procedure, Pelosi's use of manual Deitz calculations was well within established norms. Further, the fact that Pelosi's calculations lead to such minor differences and often underreported the performance of his clients' investments indicates that Pelosi had no "intent to deceive, manipulate, or defraud." Thus, this conclusion of law is erroneous.

Materiality

Missing Letters

The Decision's statements as to the missing letters depend upon an extension of logic that is not justified, as it masks serious deficiencies in the evidence put forth by the Division. Just because Pelosi did not always send his clients a letter does not mean, automatically, that the letters missing from the Commission's production were "never drafted or never sent." Id. at 24. Moreover, the Decision made no inquiry into why 80 client letters in the Division's production were not included in its calculations; rather, the Decision accepted, at face value, the Division's explanation that the letters "may be unsigned duplicates of letters. . .already accounted for." Id. These omissions call into question the entirety of the evidence the Commission presented. The

Decision erroneously notes that Pelosi failed to offer into evidence any of the missing letters, as they are included in its summary exhibit. The Decision, of course, ignores that the Division did not include them in their calculations.

1% Threshold

The Decision, citing Basic v. Levenson and Ganino v. Citizens Utilities Co., determines to "reject the 1% or 2% test Pelosi argues for, in favor of the more holistic, fact-specific approach adopted by the Supreme Court and the Second Circuit." Id. at 25. In fact, Pelosi himself argues for a "holistic, fact-specific approach:" in the context of the legitimacy of Pelosi's method of calculation, the absence of any clearly-defined procedure at Halsey, and Pelosi's continued good relationship with his clients, erroneous reports reflecting a difference of only 1% or 2% are immaterial. This is not a hard and fast rule, but one that makes sense in these circumstances. Pelosi's position is consistent with the holdings of Basic and Ganino, as articulated by the Decision.

Client Testimony

In evaluating the testimony of Pelosi's clients, the Decision does not properly address the importance of Halsey's letter regarding Pelosi's departure on his clients' thinking. Having been with Pelosi over a period of years and through several firms, his clients had adequate opportunity to determine whether or not they approved of both Pelosi himself and his manner of calculating their returns. Shortly after Pelosi left Halsey, Julian and. Zoldy sent a letter to all of Pelosi's clients informing them that he had left Halsey. While not specifically stating it, the letter unquestionably conveys the point that his departure was under questionable circumstances. This resulted, in part, by a sentence in the letter stating "[i]t has come to our attention that the performance results communicated to you may not have been accurate or complete." It then provides the "correct figures". This leaves no doubt that Halsey was claiming that Mr. Pelosi had previously provided them with falsely altered performance figures. Mr. Pelosi's clients then were aware of Halsey's allegation and were even provided with the old and supposedly new performance figures. An abstract question about whether "lying about performance is inappropriate" sheds no light on the particular circumstances of Pelosi's case. Rather, Pelosi's clients' continuing relationship with him is the best indication that any discrepancies in his performance reports were immaterial to those clients. Here, the Decision must take into account the totality of the circumstances. Viewed in that way, it is clear that Pelosi's clients regarded any discrepancies in his performance reporting as immaterial and that this conclusion of law is erroneous.

Willful Violations

The Decision correctly notes that, under Wonsover and Arthur Lipper, "[a] finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law." Id. at 26. But it does not necessarily follow that "Pelosi willfully overstated his clients' returns." Id. Because Pelosi used a well-established method of calculation, because his errors were so slight (within the one- to two-percent threshold), and because some of his calculations produced results less favorable than the Axys results, it is likely

that, contrary to the Decision's conclusion, any incorrect results *were* simply errors. Thus, it is incorrect to say, as the Decision does, that "Pelosi willfully overstated his clients' returns." And, therefore, this conclusion of law is erroneous

Penalties

Associational Bar (Revocation of Investment Adviser Registration)

Mr. Pelosi's conduct, even if examined in the harshest and least favorable light, does not approach the level of misconduct shown to warrant revocation. Revocation is appropriate only in the most outrageous of cases. By way of a brief, introductory example, consider In re Soliman, 52 S.E.C. 227 (1995). In that case, a registered investment advisor's (RIA) registration was revoked, and he was barred from association with any investment firm, because he both defrauded the IRS and, by his own admission, maintained no records related to his advisement service. As the SEC noted, his "penchant for untruthfulness about material matters [wa]s egregious." Id. at 231. Both in terms of Pelosi's intentions and the impact of his actions, these allegations, even if construed against Pelosi, do not call for revocation.

Those decisions resulting in revocation may be set out in two broad categories: (1) those in which the RIA misrepresented its background or the basis of certain material misstatements and (2) those in which the RIA engaged in fraudulent conduct. As to both categories, even a cursory review of relevant cases reveals that Mr. Pelosi is nowhere near the threshold at which revocation would be appropriate.

Further, the factors discussed in the Decision that must be considered in determining whether a bar is appropriate, when viewed in light of a proper interpretation of the facts here, are not met. There is no egregious conduct-Pelosi was simply attempting to communicate as accurately as possible with no guidance from Halsey the performance information to his clients. Pelosi had no scienter, as there was no design or intention to defraud his clients, no material misstatements and no motive. His subsequent work for several years at a different firm completely without incident evidences his sincerity to comply with the law and that it is highly unlikely that he will violate it in the future. SEC v. Steadman, 603 F2nd 1126,1140 (5th Cir. 1979).

Cease and Desist Order

A cease and desist order prevents further harm to the investing public. Moreover, a cease and desist order draws investors' attention to questionable or illegal professional conduct. Consequently, "[t]he existence of a cease and desist order. . .is clearly relevant to a reasonable investor, who is naturally interested in whether management is following the law. . ." SEC v. Merchant Capital, 483 F. 3d 747, 771 (11th Cir. 2007). See also SEC v. Paro, 468 F. Supp. 635, 646 (N.D.N.Y. 1979) (finding that investors would have been "especially dubious" of investment offer "if they had been apprised of the cease and desist order and injunctions which had been issued against" the offeror). As noted, a significant number of Pelosi's clients followed him from Halsey to his current firm, and have remained with him even when he was faced with these accusations. Thus, a cease and desist order is unwarranted not only because Pelosi's conduct is

not itself unlawful but also because, as the behavior of Pelosi's clients demonstrates, information about Pelosi's conduct would not affect their investment decisions.

Second-Tier Civil Penalties

Taking into consideration (1) the egregiousness of the defendant's conduct, (2) the degree of the defendant's scienter, (3) whether the defendant's conduct created substantial losses or the risk of substantial losses to other persons, and (4) whether the defendant's conduct was isolated or recurrent, Pelosi should not have received a second-tier penalty.

First, Pelosi's adjustment of the numbers, falling in the 1-2% range, was not egregious. Second, Pelosi did not have a required scienter to be eligible for the statute's fraud requirement. For the second tier of civil penalty to be imposed, the statute requires evidence of fraudulent, deceitful, or reckless disregard of regulatory requirement. 15 U.S.C. § 80b-9(e)(2)(B). There is no evidence of intentional or deliberate fraud by Pelosi. Pelosi's adjustment of numbers and calculations in the client letters was to ensure that his clients would have a clearer understanding of their portfolios and not because of his intent to cheat or defraud the regulatory system. Third, Pelosi's actions did not create any loss or even risk of substantial loss to his clients or his firm but rather generated a substantial profit for them. Fourth, Pelosi's actions were an isolated element of a long and successful career. Pelosi adjusted the numbers in the Halsey client letters because his 20 years of experience at other established companies indicated to him that Halsey's system of assessing and reporting the portfolios were inadequate.

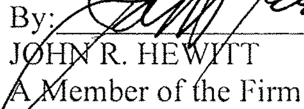
As a result of the above series of findings of material fact being clearly erroneous and the conclusions of law that being erroneous, the penalties that have been imposed upon Mr Pelosi are inappropriate and should be reversed.

CONCLUSION

For the foregoing reasons, Respondent respectfully requests that the Commission grant his petition to appeal the initial Decision of the Administrative Law Judge.

Respectfully submitted,

McCARTER & ENGLISH, LLP



By: ________________________
JOHN R. HEWITT
A Member of the Firm