via email

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15211

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In the Matter of

GREGG C. LORENZO,
FRANCIS V. LORENZO, and
CHARLES VISTA, LLC,

Respondents.

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FRANCIS V. LORENZO'S PETITION FOR REVIEW OF INITIAL DECISION

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January 27, 2014

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Pursuant to Rule 410 of the Securities and Exchange Commission's Rules of Practice, Hantman & Associates respectfully submits its Petition for Review of the Initial Decision served on January 6, 2013, upon Respondent Francis Lorenzo.

I. Summary of Discussion

Significantly, Respondent was not the primary focus of the SEC Enforcement Action brought against W2E, but was the only individual who went to trial and who, for the most part, was appearing Pro Se, as counsel was retained little more than a week before trial. Perhaps it was respondent's lack of counsel or naiveté that led him to appear at a third and crucial interview wherein his statements , while ambiguous, were the basis for the case against him.

Simply stated, this is a case of "cookie cutter" justice; following a political and bureaucratic agenda without regard to the specific facts of the case. As discussed herein, Respondent contends that the findings and the "barred for life" sanction – for an individual with a previously unblemished record who was accused of sending TWO e mails to prospective investors - applied in this case by Administrative Law Judge Foelak (hereinafter "Judge Foelak" or "ALJ") were not supported by the facts, the law, or by a preponderance of evidence in the record. As recognized by the ALJ, the total potential losses were a mere $15,000. It is submitted that, even if guilty of sending the two emails at issue, the sanctions of being "barred for life" after more than 20 years in the industry is clearly disproportionate to the acts allegedly committed by Frank Lorenzo. Specifically, the findings of "willful" violations of the antifraud provisions against Frank Lorenzo were not supported by the facts in evidence. Furthermore, the ALJ misconstrued the term "willful" in concluding that Lorenzo willfully violated the Securities Act Sections 17(a)(2) and (a)(3). Finally, Respondent contends that the sanctions imposed by the ALJ were arbitrary, capricious, inconsistent with legal standards, and not supported by the record. For these reasons, Respondent respectfully requests a review of the Initial Decision and further requests that the sanctions imposed against him be overturned or, at a minimum, reduced.

II. The Commission Failed to Prove Willful violations of Securities Act Sections 17(a) and Exchange Act Section 10(b) and Rule 10b-5

Respondent contends that the Commission failed to prove that Frank Lorenzo willfully committed securities fraud, as it was not demonstrated that he acted with the requisite scienter by a preponderance of the evidence. See *Aaron v. Securities and Exchange Commission*, 446 U.S. 680, 100 S. Ct. 1945, 64 L. Ed. 2d 611 (1980); *Ernst & Ernst*, 425 U.S. 185, 96 S. Ct. 1375, 1382 and n. 12 (1976) (Scienter requires an intent to deceive, manipulate or defraud - not just innocently or negligently.) Although the ALJ attempted to differentiate between the level of intent required under Section 17(a)(1) and Sections 17(a)(2) and (a)(3), the Commission and the ALJ failed to show how Lorenzo "willfully" violated sections 17(a)(2) and (a)(3) of the Securities Act based on the factual evidence in this case – that is, the lone act of being ordered to send out two emails simultaneously, which were actually prepared by his superior Gregg Lorenzo. The ALJ's finding that Frank was negligent in sending out the two emails does not necessarily lead to a conclusion that he "willfully" violated the anti-fraud provisions of the Securities Act Sections 17(a)(2) and (a)(3).

Indeed, the record evidence fails to establish that respondent had the requisite intent to deceive, defraud or manipulate the recipients of those two emails into purchasing the W2E debentures, as he did not know them and did not even follow up on the emails. He was not their broker, and sent the emails only at the urging of the principal of the firm Charles Vista.

Moreover, the Initial Decision erroneously concludes that Lorenzo willfully violated Exchange Act Section 10(b) and Rule 10b-5, which would have required a showing of scienter by a preponderance of the evidence, which the ALJ acknowledges. However, neither the record nor the Initial Decision provide factual or legal support in finding that Frank Lorenzo violated Section 10(b) and Rule 10b-5 with intent to defraud the two Charles Vista clients by his act of sending two emails directed by his superior Gregg Lorenzo, who was the principal respondent and did not go to trial .

Accordingly, Respondent petitions for a review of the Initial Decision in finding that he willfully violated the anti-fraud provisions of the Securities and Exchange Act.

III. Sanctions Ordered were Severe and Disproportionate

Naturally, Respondent's ability to earn a livelihood in his chosen field for over 20 years is now in jeopardy. Worse, the sanctions applied were shockingly similar to a previous decision rendered by Judge Foelak, the facts of which were far more egregious than the acts complained of herein.

A. Summary of facts

The record evidence in this case reveals that Francis Lorenzo was neither a principal nor an owner of Charles Vista, and was never in a compliance or supervisory position while registered with the Company. The environment at Charles Vista was one of tension and animosity; the Company culture was one of stress and disrespect. During the time Frank worked at Charles Vista, he expressed his concerns that the Company was not well-diversified, and mentioned several times that too much of the Company's assets were in W2E, and that this subjected both the clients and the firm to far too much risk exposure. More importantly, there was no proof submitted by the Commission that Frank Lorenzo knew of or had any previous relationship with W2E, or that he personally benefited from the sale of the debentures.

The record reveals that since at least April 2009, respondent had been asking W2E about the origin of its purported "intangible" assets. (Tr. at 331:8-20; Div. Ex. 27). For example, on April 29, 2009, Lorenzo emailed W2E executives about the "Approximately $10mm" of "intangibles" and asked "[c]an someone tell me what this is?" (Div. Ex. 27 at 2.). However, Lorenzo never received any adequate answers from either W2E or his superiors at Charles Vista, Gregg Lorenzo and Adam Spero.

Subsequently, on or about October 14, 2009, Gregg Lorenzo instructed Respondent to send out two emails that he had prepared for potential investors Dr. Carey Williams and Mr. Vishal Goolcharan. Apparently, Gregg Lorenzo wanted them to come from the Charles Vista investment banking department. Frank Lorenzo was not the registered broker for either of these men, nor did he know either of these two men personally, and did not know anything about their relationship to Charles Vista. While admittedly improper, he sent out the emails because his superior, Gregg Lorenzo, instructed him to do so. Moreover, the Commission did not provide any conclusive proof to support the finding that "he knew or should have known" about the misrepresentations made in the email at the time they were sent.

The emails explicitly stated that they were sent at the request of W2E executives Adam Spero and Gregg Lorenzo from the investment banking division of Charles Vista. More importantly, the record reveals that on his own recognizance, Frank Lorenzo gave his statements to the Commission, without retaining a lawyer, for the purpose of aiding the Commission, and particularly those who purchased the W2E debentures. However, rather than acknowledging his cooperation and honesty, his, voluntary statements are being misconstrued and used against him. However, his statements are ambiguous and unclear as to what he knew when the emails were sent out. Further, the Commission did not prove, by a preponderance of the evidence, that his act of sending out the emails was a willful, intentional act of deceiving or defrauding the two recipients who, at most, lost a combined $ 15,000, in addition to the fact that one of the emails went found in a spam file only after the fact.

B. Judge Foelak's Decision is Shockingly Similar to a Prior Decision

Notwithstanding the record evidence submitted in this case, Judge Foelak's decision Is almost identical to a case she heard last year (which was actually argued by the same lawyers for the Commission, Kaufman and Janghorbani). See *Gualario & Co., LLC and Ronald Gualario*, Initial Decision Release No. 452 (February 14, 2012).

Although the case brought against Gualario is factually distinguishable from the facts in this matter, the similarity of the outcome between these decisions is just too close - its almost as if Judge Foelak just substituted out the facts of the *Gualario* case for Lorenzo's facts in reaching the same decision and sanctions against both respondents.

In *Gualario*, there was an ongoing scheme to defraud investors, during 2006 and 2007, and the respondents raised more than $8 million from the sale of promissory notes and limited partnerships in a hedge fund from their existing customers. By November 2007, the money had been spent or lost in trading, mostly in ways that were at variance to the representations made to the investors. *Gualario & Co., LLC and Ronald Gualario*, Initial Decision Release No. 452 (February 14, 2012) at 18.

Gualario received similar penalties as Lorenzo – a cease and desist order, third-tier civil money penalty ($390,000), and a bar from the industry. Although the facts of *Gualario* and *Lorenzo* are incredibly dissimilar, Judge Foelak reached the same decision in both instances.

For example, when discussing Gualario's sanctions, Judge Foelak states:

> "Respondents' conduct was egregious and recurrent, continuing for more than one year. The conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of the conduct goes beyond a vigorous defense of the charges. Gualario's attempt to displace blame onto Lin and Merlin Securities is an aggravating factor. His chosen occupation in the financial industry will present opportunities for future violations. The violations were neither recent nor remote in time, having ended about four years ago. The degree of harm to the marketplace is quantified in the approximately $8 million in proven losses to investors that resulted from Respondents' misconduct. In light of these considerations, a cease-and-desist order is appropriate."

Gualario & Co., LLC at 18.

The same paragraph in Lorenzo's decision, states:

> "Frank Lorenzo's conduct was egregious and repeated - he sent the violative email to two people. The conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of the conduct goes beyond a vigorous defense of the charges. His attempt to displace blame onto both Gregg Lorenzo and W2E is an aggravating factor. His chosen occupation in the financial industry will present opportunities for future violations. The violations were neither recent nor remote in time, having occurred about four years ago. The evidence of record does not quantify the degree of harm to the marketplace in dollars but harm is evident from the dishonest nature of Frank Lorenzo's misconduct. In light of these considerations, a cease and desist order is appropriate."

It is apparent that the ALJ simply plugged in the facts from Lorenzo's case into the earlier decision, when they just don't fit. Specifically, Judge Foelak referenced Gualario's conduct as being "egregious and recurrent" because it continued for more than one year, but then she stated that Frank's conduct was "egregious and repeated" when it was two emails sent over the course of one afternoon (which could arguably be considered one "act", because they were sent right after another, without time to think in between, and as part of the same request from Lorenzo's supervisor). The facts of this case are clearly dissimilar in the level of egregiousness and number of times committed, yet the ALJ applied the same argument in support of her decision to bar Lorenzo from the industry by essentially cut and pasting the facts of Lorenzo's case into the earlier decision.

As to the issue with the "Civil Money Penalty" section, it is once again essentially the same decision. Not only is the boilerplate legal background identical, the analysis is virtually the same, despite the fact that these cases are vastly dissimilar. For example, the *Gualario* decision states:

> Penalties are in the public interest in this case. Penalties in addition to the other sanctions ordered are necessary for the purpose of deterrence. See Sections 21B(c)(5) of the Exchange Act and 203(i)(3)(E) of the Advisers Act; see also H.R. Rep. No. 101-616 (1990). The Division requests that Respondents be ordered to pay third-tier penalties, without specifying dollar amounts or units of violation. In addition to arguing that there were no violations, Respondents argue that civil penalties are not warranted, much less third-tier penalties. Third-tier penalties, as the Division requests, are appropriate because Respondents' violative acts involved fraud and resulted in substantial losses to other persons. See Sections 21B(b)(3) of the Exchange Act and 203(i)(2)(C) of the Advisers Act. Under those provisions, for each violative act or omission after February 14, 2005, the maximum third-tier penalty is $130,000 for a natural person and $600,000 for any other person. 17 C.F.R. §§ 201.1003. The provisions, like most civil penalty statutes, leave the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979).

Gualario & Co., LLC, at 29.

The same paragraph in the *Lorenzo* decision reads:

> Penalties are in the public interest in this case. Penalties in addition to the other sanctions ordered are necessary for the purpose of deterrence. See Section 21B(c) (5) of the Exchange Act; H.R. Rep. No. 101-616, at 17 (1990) U.S.C.C.A.N. 1379, 1384. The Division requests that Frank Lorenzo be ordered to pay third-tier penalties, without specifying dollar amounts or units of violation. In addition to arguing that there were no violations, Respondent argues that civil penalties are not warranted, much less third-tier penalties. A third-tier penalty, as the Division requests, is appropriate because Frank Lorenzo's violative acts involved fraud and resulted in the risk of substantial losses to other persons. See Section 21B(b)(3) of the Exchange Act. Under that provision, for each violative act or omission during the time at issue the maximum third-tier penalty is $150,000 for a natural person. 17 C.F.R. § 201.1004. The provision, like most civil penalty statutes, leaves the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979).

Upon reading both passages, it is undeniable that the two paragraphs are nearly identical. The only difference is that, in the second decision, Lorenzo's name is substituted for the word "respondents" used in the *Gualario* decision.

This pattern of similarities is evident throughout the decision, with the *Lorenzo* decision bearing an uncanny similarity to the *Gualario* decision. However, in the *Gualario* case, the acts committed were much more severe and completely dissimilar to the facts in this case. Further, the respondent in this case had an unblemished record, was not a principal, cooperated with the SEC, and voluntarily testified.

IV. The Sanctions Imposed Do Not Comply With the Applicable Standards

The Initial Decision cites *SEC v. Steadman* as the standard rule of law in determining the appropriate sanctions in this case. In *Steadman*, the ALJ is to consider such factors as:

> [T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the

> likelihood the defendant's occupation will present opportunities for future violations.

SEC v. Steadman, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting *SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)).

A. The Egregiousness of the Defendant's Actions

The Initial Decision concludes that he "willfully" violated the anti-fraud provisions of the Securities Act Sections 17(a)(2) and (a)(3) and Exchange Act Section 10(b) and Rule 10b-5. However, the record evidence shows that Respondent's actions were negligent at best, as he was simply following orders from his superior. His actions of sending out two emails, one of which was never opened, caused one investor to lose $15,000. As compared to the *Gualario* case, the amount of monetary loss caused by Lorenzo's act pales in comparison to the "egregious" conduct by Gualario in scheming $8 million out of investors.

B. The Degree of Scienter Involved

The Initial Decision states that Lorenzo's conduct was "reckless." However, neither the Commission nor the record provides sufficient proof by a preponderance of the evidence that Lorenzo's conduct of sending out two emails prepared and directed by his superior was "reckless" to the degree of establishing scienter. This finding was completely discretionary given the testimony provided by Lorenzo that he was just an overworked/overstressed man that did not realize what he was doing when he sent out those two emails that day, other than following an order given to him by his superior, Gregg Lorenzo.

C. The Sincerity of the Defendant's Assurances Against Future Violations

Respondent, who is single, lives in New Jersey, does not work in the "micro cap" field anymore, supports his mother, and is active in his Church and community has apologized many times for his limited involvement with the W2E debentures while working at Charles Vista. The record evidence and the testimony of Lorenzo supports the finding that upon discovering the truth regarding the firm and the W2E debentures, he did all that he could to cooperate with the Commission and has attempted to assist those that lost money investing in the debentures. Indeed, respondent tried to help Charles Vista clients put together a class action lawsuit against the company. Finally, respondent has worked in the industry for decades, and this is the one and only time that he has ever been charged with violating the securities laws.

D. <u>The Likelihood That the Defendant's Occupation Will Present Opportunities for Future Violations</u>

Respondent has never committed any previous violations during his 26 years in the financial industry. There is no reason to believe that this one act would make it likely that he will commit future violations. Accordingly, it appears that Judge Foelak weighed some of the factors more heavily than others in order to support her findings and conclusions.

V. <u>Sanctions Should be Overturned</u>

For the reasons stated herein, the sanctions imposed against Lorenzo should be overturned. Barring him from working in the financial industry for life is harsh and unreasonable based on the facts of this case coupled with the fact that respondent had a clean record leading up to this case, and there is no proof that there is a reasonable likelihood that Lorenzo can never act in compliance with the law.

In *SEC v. Blatt*, the standard for overturning a sanction was discussed as follows:

> The fashioning of an appropriate and reasonable remedy is for the Commission, not this court, and the Commission's choice of sanction may be overturned only if it is found "unwarranted in law or . . .

> without justification in fact." American Power & Light Co. v. SEC, 329 U.S. 90, 112-13, 67 S. Ct. 133, 146, 91 L. Ed. 103 (1946), Quoted in Butz v. Glover Livestock Commission Co., 411 U.S. at 185-86, 93 S. Ct. at 1458.
>
> In our view, however, permanent exclusion from the industry is "without justification in fact" unless the Commission specifically articulates compelling reasons for such a sanction. For example, the facts of a case might indicate a reasonable likelihood that a particular violator cannot ever operate in compliance with the law, See SEC v. Blatt, 583 F.2d 1325, 1334 (5th Cir. 1978), or might be so egregious that even if further violations of the law are unlikely, the nature of the conduct mandates permanent debarment as a deterrent to others in the industry, see p. 1142 Infra. We do not intend to limit the Commission by indicating these possible grounds for debarment, but rather give them as examples of the type of situation that would seem to justify that penalty. With this in mind, we proceed to examine the sanctions imposed upon Steadman.

SEC v. Blatt, 583 F.2d at 1334 n.29.

To say that past misconduct gives rise to an inference of future misconduct is not enough. What is required is a specific enumeration of the factors that merit permanent exclusion. In this case, the fact that this act occurred four years ago, and that Lorenzo has not violated any rules previously, or since then, seems to be more indicative of the finding that he is not likely to violate the securities laws and that this was merely a one-time lapse in judgment.

In regards to the civil money penalties imposed, the ALJ is supposed to consider the following factors: 1) the "fraud" that occurred; 2) harm caused to others; 3) unjust enrichment; 4) previous violations; 5) deterrence; and such other matters as justice may require. Here, there was no unjust enrichment, as Lorenzo did not personally profit from these emails. The only harm to others was a risk of harm to others, not actual harm to others. Lorenzo has already expressed his sincere apologies for being involved with

Charles Vista and has already cooperated with the Commission to aid those who invested in the debentures through Charles Vista.

The ALJ's sole basis for barring Frank Lorenzo from working in the industry is because of "a lack of recognition of the wrongful nature of the violative conduct," and not the actual substantive facts of the case to warrant such a harsh penalty.

Pursuant to FINRA's guidelines, an industry bar is only appropriate in "egregious" cases. Although what constitutes "egregious" behavior appears to be discretionary, it seems that the ALJ is placing an enormous amount of weight on the fact that Lorenzo didn't seem to think he did anything wrong at the time he sent those emails although he later admitted that he was so sorry he ever sent the emails.

The bar from the industry also doesn't seem to align with the level of severity that the ALJ has pegged to Lorenzo's actions when determining the monetary fine. For his conduct, Lorenzo was fined $15,000. There is clearly a disconnect between the record findings of Lorenzo's conduct, the loss which occurred as a result of his conduct, and the "egregiousness" of his act which would warrant barring him from the industry for life.

Further, the record evidence establishes that respondent had ongoing frustrations with his superior, Gregg Lorenzo, and the deplorable corporate culture at Charles Vista, which caused him to mentally "check out.. As a result, he failed to question Gregg Lorenzo about the purpose and accuracy of the contents of the two emails at issue. While wrong, and while respondent accepts responsibility for his acts, this does not equate to the type of egregious behavior deserving of the sanctions ordered by the Administrative Law Judge. It is submitted that his actions were aberrational, not consistent with his normal behavior, out of character, and an anomaly.

Moreover, his voluntary testimony before and during the hearing was forthright, and he was genuinely apologetic for his actions. Based on the foregoing, it is submitted that the findings of the Administrative Law Judge constitute an abuse of discretion and the degree of punishment was not warranted pursuant to the law, and completely out of proportion to the nature of Lorenzo's conduct.

VI. Conclusion

For the foregoing reasons, Respondent requests a review of the Initial Decision and that the sanctions be overturned or modified to be proportionate the act committed by Frank Lorenzo.

Respectfully Submitted,

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EXHIBIT A

INITIAL DECISION RELEASE NO. 544
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15211

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

In the Matter of

GREGG C. LORENZO,
FRANCIS V. LORENZO, and
CHARLES VISTA, LLC

INITIAL DECISION AS TO
FRANCIS V. LORENZO[1]
December 31, 2013

APPEARANCES: Alex Janghorbani and Jack Kaufman for the Division of Enforcement, Securities and Exchange Commission

Robert J. Hantman of Hantman & Associates for Respondent Francis V. Lorenzo

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision (ID) concludes that Respondent Francis V. Lorenzo (Frank Lorenzo or Respondent) violated the antifraud provisions of the federal securities laws when he sent two potential investors emails containing false and misleading information about his firm's client. The ID orders him to cease and desist from violations of the antifraud provisions, bars him from the securities industry, and orders him to pay a civil money penalty of $15,000.

[1] The proceeding has ended as to Respondents Gregg C. Lorenzo and Charles Vista, LLC, who settled the charges against them. Gregg C. Lorenzo, Securities Act Release No. 9480, 2013 WL 6087352 (Nov. 20, 2013) (Settlement Order). The Settlement Order made various findings, including findings that Francis V. Lorenzo (Frank Lorenzo) engaged in various conduct, including conduct concerning which there was no evidence at Frank Lorenzo's hearing on September 18-19, 2013. It must be stressed that the only basis on which the undersigned or the Securities and Exchange Commission may evaluate Frank Lorenzo's conduct in this proceeding is the evidence adduced at his September 18-19, 2013, hearing.

I. INTRODUCTION

A. Procedural Background

The Commission instituted this proceeding with an Order Instituting Proceedings (OIP) on February 15, 2013, pursuant to Section 8A of the Securities Act of 1933 (Securities Act) and Sections 15(b), 21B, and 21C of the Securities Exchange Act of 1934 (Exchange Act). The undersigned held a two-day hearing in New York City on September 18-19, 2013. Three witnesses testified, including Frank Lorenzo, and numerous exhibits were admitted into evidence.[2]

The findings and conclusions in this ID are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the parties' Proposed Findings of Fact and Conclusions of Law[3] were considered. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

B. Allegations and Arguments of the Parties

This proceeding concerns Frank Lorenzo's dealings with customers of Charles Vista, LLC (Charles Vista), a registered broker-dealer owned by Gregg C. Lorenzo (Gregg Lorenzo), during the fall of 2009. The OIP alleges that Lorenzo sent at least two Charles Vista customers emails containing false and misleading statements concerning the assets and business of Waste2Energy Holdings, Inc. (W2E), a start-up waste management company for which Charles Vista was attempting to sell convertible debentures.

The Division of Enforcement (Division) is seeking a cease-and-desist order, a third-tier civil money penalty, and a bar. Respondent argues that the charges are unproven and no sanctions should be imposed.

II. FINDINGS OF FACT

As discussed below, on October 14, 2009, Frank Lorenzo sent two potential investors emails that contained false and misleading information about W2E.

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[2] Citations to the transcript will be noted as "Tr. __." Citations to exhibits offered by the Division of Enforcement (Division) and by Respondent will be noted as "Div. Ex. __" and "Resp. Ex. __," respectively.

[3] Reference to the Division's and Respondent's Proposed Findings of Fact and Conclusions of Law will be noted as "Div. Br." and "Resp. Br.," respectively.

A. Relevant Individuals and Entities

1. Charles Vista, Gregg Lorenzo, and Frank Lorenzo

Charles Vista was a registered broker-dealer that Gregg Lorenzo owned and operated since 2009.[4] Tr. 291; Div. Ex. 132 at 13. Charles Vista and Gregg Lorenzo have settled the charges against them in this proceeding. See Gregg C. Lorenzo, Securities Act Release No. 9480 (Nov. 20, 2013), 2013 WL 6087352 (Settlement Order). According to the Settlement Order, Gregg Lorenzo engaged in numerous fraudulent activities in connection with the business of Charles Vista. His previous ten years as a registered representative, associated with various broker-dealers, were studded with disciplinary issues.[5]

Frank Lorenzo has worked in the securities industry for over twenty-five years. Tr. 185-90; Div. Ex. 25; Resp. Ex. 1 at 4-5. In 2007, he joined Mercer Capital, Ltd. (Mercer Capital), where he was the firm's investment banker.[6] Tr. 187-89; Div. Ex. 25; Resp. Ex. 1 at 4-5. There, he met Gregg Lorenzo. Tr. 304-05; Div. Ex. 132 at 11-13. Frank Lorenzo and Gregg Lorenzo are not related. Tr. 305. Frank Lorenzo followed Gregg Lorenzo to John Thomas Financial, Inc., and then, when he found that firm too stressful, to Charles Vista, in February 2009. Tr. 181, 189-90; Div. Ex. 25 at 1; Resp. Ex. 1 at 4-5.

At Charles Vista, Frank Lorenzo was the director of investment banking. Tr. 66, 89, 181, 403; Div. Ex. 25 at 1. By the summer of 2009, Frank Lorenzo knew that Charles Vista was a "boiler room," as his assistant told him that the firm's brokers were engaged in high-pressure sales and stretching the truth to clients, and by the fall of 2009, he doubted the prudence of how Charles Vista handled clients' money. Tr. 229-30, 291-92, 299-302, 323-24, 383, 404-05. He left Charles Vista in February 2010, and has continued to work in the securities industry, currently at Hunter Wise Securities, LLC, a registered broker-dealer. Tr. 181, 311; Div. Ex. 25 at 1; Resp. Ex. 1 at 4.

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[4] According to Financial Industry Regulatory Authority, Inc. (FINRA), records, Charles Vista withdrew its registration as a broker-dealer on June 17, 2013. Additionally, FINRA cancelled Charles Vista's membership on July 31, 2013, for failure to pay outstanding fees. See http://brokercheck.finra.org (last visited Dec. 3, 2013). Official notice, pursuant to 17 C.F.R. § 201.323, is taken of these records. See Joseph S. Amundsen, Exchange Act Release No. 69406 (Apr. 18, 2013), 2013 SEC Lexis 1148, at *2 n. 1.

[5] According to FINRA records, FINRA permanently barred Gregg Lorenzo from association with any member, effective November 14, 2013, for his refusal to comply with multiple requests to appear for an on-the-record interview; the records also indicate an extensive state disciplinary record, including by the states of Idaho, Iowa, and Montana. See http://brokercheck.finra.org (last visited Dec. 3, 2013).

[6] According to FINRA records, Mercer Capital, Ltd, terminated or withdrew its membership as of January 15, 2010. See http://brokercheck.finra.org (last visited Dec. 3, 2013).

During the time he worked at Charles Vista, Frank Lorenzo was paid about $120,000 but incurred expenses of $60,000 to $80,000 for which he was promised, but did not receive, reimbursement. Tr. 297-98. Except for the events at issue, Frank Lorenzo has had no disciplinary issues as a registered representative. Tr. 336-37.

2. Waste2Energy Holdings, Inc. (W2E)

W2E is central to the events at issue. Tr. passim; Div. Exs. passim. W2E was a renewable energy company, founded in 2007 and made public in early 2009, which engaged Charles Vista for investment banking support. Tr. 42, 66, 77-78, 141; Div. Ex. 3 at 3. In September 2009, W2E was preparing to offer up to $15 million in 12% convertible debentures, and Charles Vista was the placement agent for this offering. Tr. 85-89; Div. Ex. 1 at page 19 of 112; Div. Ex. 3. As placement agent for the offering, Charles Vista was positioned to earn substantial fees, including a 10% commission on sales of the debentures. See Div. Ex. 3 at iii.

W2E was in terrible financial shape during Frank Lorenzo's time at Charles Vista. Tr. 198-99. W2E's technology – aimed at converting solid waste into electricity – did not work. Tr. 42, 190, 199; see Div. Ex. 3 at 3, 21-22 (describing what the company does). W2E was placed into bankruptcy in 2012. Tr. 96, 139-40, 387; Div. Ex. 53 at 3-4.

Part of Frank Lorenzo's job as Charles Vista's head of investment banking was to conduct due diligence of investment banking clients, such as W2E, which included reviewing their filings with the Commission. Tr. 182-83, 197-98, 231-32. As Charles Vista's investment banker, Frank Lorenzo was responsible for overseeing the W2E relationship, and he was W2E's primary point of contact at Charles Vista. Tr. 65-66, 95, 155, 327-28. Indeed, the majority of Frank Lorenzo's responsibilities at Charles Vista related to W2E. Tr. 197.

B. W2E Asset Write-Off

On June 3, 2009, W2E filed a Form 8-K that contained unaudited financial statements as of December 31, 2008; the balance sheet listed about $14 million in total assets, which included about $10 million in "intangibles," and about $470,000 in "goodwill." Tr. 57, 201; Div. Ex. 15[7] at page 63 of 175. The intangibles figure referred to the valuation assigned to the company's intellectual property (essentially the technology to turn waste into energy), and the goodwill figure referred to the valuation assigned to the company's workforce. Tr. 56-57. Frank Lorenzo reviewed this Form 8-K in June 2009. Tr. 121.

W2E filed an amended Form 8-K (8-K/A) on October 1, 2009, with audited March 31, 2009, fiscal year-end financial statements. Tr. 58, 227; Div. Ex. 16. The balance sheet for the year ended March 31, 2009, reported no intangibles; following months of auditing work by W2E's independent accountants, the company had written the intangibles down to zero. Tr. 59-60, 69; Div. Ex. 16 at pages 46, 69 of 137. W2E also had written down the value of the goodwill to zero. Tr. 60, 70. With these substantial supposed assets entirely written down, the Form 8-K/A ultimately

[7] W2E was previously known as Maven Media Holdings. Tr. 54-55.

reflected under $370,600 in audited total assets for the year ended March 31, 2009 – i.e., under 3% of the total assets reflected in the December 31, 2008, balance sheet. Compare Div. Ex. 16 at page 69 of 137 with Div. Ex. 15 at page 63 of 175.

Also on October 1, 2009, W2E filed a Form 10-Q. Tr. 58, 67; Div. Ex. 22. This Form 10-Q, for the quarterly period ended June 30, 2009, again did not list any intangibles, and listed audited total assets under $370,600 for the year ended March 31, 2009. Div. Ex. 22 at page 4 of 45. It further listed audited total liabilities of over $6.6 million for the year ended March 31, 2009. Id.

On October 1, 2009, Frank Lorenzo reviewed both the Form 8-K/A and the Form 10-Q filed on that day. Tr. 231, 241; Div. Ex. 32. Indeed, he shared the filings with all brokers at Charles Vista early on October 2. Tr. 233, 243; Div. Ex. 21. October 2009, however, was not the first time Frank Lorenzo had heard about the write-off of the majority of W2E's claimed assets; he had known about the write-off at least since the prior month. Tr. 116, 144, 154-55, 220-21; Div. Ex. 18. Furthermore, prior to October 2009, Frank Lorenzo had speculated that the intangibles were not in fact worth close to the $10 million W2E has previously claimed. Tr. 268. Frank Lorenzo believed that the amount written off was material, and thought the fact of the write-off was a "big deal." Tr. 216-17, 231, 243-44.

Following his receipt of the Forms 8-K/A and 10-Q, and prior to October 14, 2009, Frank Lorenzo was involved in a discussion between Charles Vista and W2E regarding the asset write-off. Tr. 74-77, 122-23, 249-51; Div. Exs. 19, 42.

C. The Two Emails

On October 14, 2009, Gregg Lorenzo asked Frank Lorenzo to send an email that Gregg Lorenzo had drafted relating to the debenture offering to two Charles Vista clients – William Rothe (Rothe) and Vishal Goolcharan (Goolcharan) – saying that he wanted the emails to come from Charles Vista's investment banking division. Tr. 173, 257-59, 264, 343-44, 346, 381-82; Div. Ex. 49. Frank Lorenzo heeded Gregg Lorenzo's instruction without question, sending an almost identical email to each client on that day.[8] Tr. 176-77, 257-58, 341, 346, 378, 381-82, 403-04; Div. Ex. 34. The email read in full:

> Dear Sir:
>
> At the request of Adam Spero and Gregg Lorenzo, the Investment Banking division of Charles Vista has summarized several key points of the Waste2Energy Holdings, Inc. Debenture Offering.
>
> *** Please read the Offering Memorandum, including all "Risk Factors" ***
>
> 12- month Note, Debenture pays a 12% interest rate, paid quarterly

[8] The email to Goolcharan states that it was sent at the request of Adam Spero and Gregg Lorenzo, while the email to Rothe states that it was sent at the request of Gregg Lorenzo.

A sinking fund has been created, handled by 3rd party (SRFF attorney). Interest payment amount will be held in the sinking fund

This is senior debt. There is no other debt (other than simple debt). These debenture holders have to approve (51%) any other debt.

If there is a liquidation, these debenture holders get paid first.

<u>There are 3 layers of protection:</u>

<u>(I) The Company has over $10 mm in confirmed assets</u>
<u>(II) The Company has purchase orders and LOI's for over $43 mm in orders</u>
<u>(III) Charles Vista has agreed to raise additional monies to repay these Debenture holders (if necessary)</u>

Debenture Holders have the option to convert their debt at $1.00 into common stock. These shares would have been already added to the Registration Statement.

Debenture Holders will receive a 3-year warrant to purchase shares of the company's stock at $2.00 per share. Debenture Holders will receive this warrant regardless if they convert or not.

Please call with any questions-

Truly,

Francis V. Lorenzo
Vice President - Investment Banking
Charles Vista, LLC.
100 William Street
18th Floor, Suite 1820
New York, NY 10038
Direct: 646.422.3113
Toll Free: 800.799.9070
Main: 212.690.6000
Fax: 212.690.6000
<u>...@charlesvista.com</u>

Div. Ex. 34 (emphasis added). While Frank Lorenzo knew the truth about W2E's parlous financial condition, the emails contained extensive false information, including regarding the company's "three layers of protection." Tr. 269, 283-90, 324-25. Frank Lorenzo does not take personal responsibility for having sent false information to potential investors. Rather, he blames both Gregg Lorenzo for having asked him to send the emails, Tr. 261; Div. Ex. 132 at 141, and W2E, for (as Frank Lorenzo contends) having not sufficiently brought the information about the asset write-off to his attention, Tr. 231, 246-48, 365. Rothe never invested in the debentures,[9] but Goolcharan did, in the amount of $15,000. Tr. 93-94, 177-78, 260; Div. Ex. 54. Lorenzo earned $150 on Goolcharan's investment. Tr. 412.

Frank Lorenzo sent the emails without even thinking about the contents: "I just didn't give it much thought at the time. My boss asked me to send these e-mails out and I sent them out." Tr. 347. "The guy owns the firm. He just asked me to send out an e-mail for him. I am going to tell him no?" Tr. 382. "I didn't really think about it one way or another. Unfortunately, I hit the send button and it's caused me a lot of grief." Tr. 366. The emails were "erased from my memory two seconds after I sent [them]." Id. Frank Lorenzo characterized his actions as a "mistake" numerous times in his testimony. Tr. 260, 264, 269, 294, 298, 365-67, 370-73.

D. Ability to Pay

At the hearing and in his Proposed Findings of Fact and Conclusions of Law, Frank Lorenzo suggested that he is somewhat impecunious. Tr. 297-98, 354, 385, 401; Resp. Br. at 1 n.1, 6-7. However, he has not otherwise affirmatively asserted an inability to pay a civil money penalty. Nor has he introduced evidence such as financial statements to support such an assertion. Accordingly, Frank Lorenzo has not demonstrated an inability to pay any penalty that may be ordered in this proceeding.

III. CONCLUSIONS OF LAW

The OIP charges that Frank Lorenzo willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. As discussed below, it is concluded that he willfully violated those provisions.

A. Antifraud Provisions

Frank Lorenzo is charged with willfully violating the antifraud provisions of the Securities and Exchange Acts – Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder – which prohibit essentially the same type of conduct. United States v. Naftalin, 441 U.S. 768, 773 n.4, 778 (1979); SEC v. Pimco Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004).

Section 17(a) of the Securities Act makes it unlawful "in the offer or sale of" securities, by jurisdictional means, to:

> 1) employ any device, scheme, or artifice to defraud;
>
> 2) obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary to make the statement made not misleading; or

[9] Rothe, however, read Frank Lorenzo's email. Tr. 177-78.

3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Similar proscriptions are contained in Exchange Act Section 10(b) and Rule 10b-5.

Scienter is required to establish violations of Securities Act Section 17(a)(1) and Exchange Act Section 10(b) and Rule 10b-5. Aaron v. SEC, 446 U.S. 680, 690-91, 695-97 (1980); SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is "a mental state embracing intent to deceive, manipulate, or defraud." Aaron, 446 U.S. at 686 n.5; Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976); SEC v. Steadman, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. See David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); SEC v. Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is "conduct which is 'highly unreasonable' and represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)).

Scienter is not required to establish a violation of Securities Act Section 17(a)(2) or 17(a)(3); a showing of negligence is adequate. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); SEC v. Steadman, 967 F.2d at 643 & n.5; Steadman v. SEC, 603 F.2d 1126, 1132-34 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

Material misrepresentations and omissions violate Securities Act Section 17(a) and Exchange Act Section 10(b) and Rule 10b-5. The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not 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); SEC v. Steadman, 967 F.2d at 643.

1. Willfulness

In addition to requesting a cease-and-desist order pursuant to Sections 8A of the Securities Act and 21C(a) of the Exchange Act, the Division requests sanctions pursuant to Sections 15(b) and 21B of the Exchange Act. Willful violations by Respondent must be found in order to impose sanctions on them pursuant to those provisions. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d at 1135; Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

2. Selective Prosecution

Frank Lorenzo suggests that charging him and not other Charles Vista staffers constitutes selective prosecution. "Selective prosecution," however, is a term of art. "To establish such a claim, a petitioner must demonstrate that he was unfairly singled out for prosecution based on improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right." Scott Epstein, Exchange Act Release No. 59328 (Jan. 30, 2009), 95 SEC Docket 13833, 13856; accord Robert Radano, Advisers Act Release No. 2750 (June 30, 2008), 93 SEC Docket 7495, 7510 n.74. No such showing was made here. Rather, the Division's decision to charge Frank Lorenzo and not to charge other individuals was an exercise of prosecutorial discretion. Robert Radano, 93 SEC Docket at 7510 n.74. (citing Dolphin and Bradbury, Inc., Exchange Act Release No. 54143 (July 13, 2006), 88 SEC Docket 1298, 1318, aff'd, 512 F.3d 634 (D.C. Cir. 2008)).

B. Antifraud Violations

The record shows that Frank Lorenzo violated the antifraud provisions by making material misstatements and omissions in the emails. The falsity of the representations in the emails is staggering. The only possible issue is the degree of Frank Lorenzo's culpability. While denying that he intended to defraud, he admits that he was negligent, which as a threshold shows a violation of Securities Act Sections 17(a)(2) and (3). Further, the evidence shows that he was reckless – although he knew that W2E was in terrible financial shape, he sent the emails without thinking. Had he taken a minute to read the text, he would have realized that it was false and misleading and that W2E was not worth anything near what was being represented to potential investors. Also, he cannot escape liability by claiming that Gregg Lorenzo ordered him to send the emails. The fact that Gregg Lorenzo contributed to the misrepresentation does not relieve Frank Lorenzo from responsibility. See James J. Pasztor, 54 S.E.C. 398, 406-07, 411-13 (1999) (supervisor held liable for registered representative's execution of violative directed trades; supervisor had tried to stop the trading but was overruled by broker-dealer's owner who was friendly with the customer); Charles K. Seavey, 56 S.E.C. 357, 364-65, 368 (2003) (associated person found liable where investment adviser required him to sign materially misleading letter), aff'd, 111 F. App'x. 911 (9th Cir. 2004).

In sum, it is concluded that Frank Lorenzo willfully violated the antifraud provisions of the Securities and Exchange Acts by his material misrepresentations and omissions concerning W2E in the emails.

IV. SANCTIONS

The Division requests a cease-and-desist order, a third-tier civil money penalty, and an industry bar.[10] As discussed below, Frank Lorenzo will be ordered to cease and desist from violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, ordered to pay a third-tier civil penalty of $15,000, and barred from the securities industry.[11]

[10] The Division does not seek disgorgement. Div. Br. at 26 n.5.

[11] The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which became effective on July 22, 2010, provided collateral bars in each of the several statutes regulating different aspects of the securities industry. Frank Lorenzo's wrongdoing occurred before July 22, 2010. However, the Commission has determined that sanctioning a respondent with a collateral bar for pre-Dodd-Frank wrongdoing is not impermissibly retroactive, but rather provides prospective relief from harm to investors and the markets. John W. Lawton, Advisers

A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, 56 S.E.C. 695, 698 (2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schield Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46. As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, 55 S.E.C. 1133, 1145 (2002), aff'd, 340 F.3d 501 (8th Cir. 2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

B. Sanctions

1. Cease and Desist

Securities Act Section 8A and Exchange Act Section 21C(a) authorize the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of those Acts or rules thereunder. Whether there is a reasonable likelihood of such violations in the future must be considered. KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1185 (2001). Such a showing is "significantly less than that required for an injunction." Id. at 1183-91. In determining whether a cease-and-desist order is appropriate, the Commission considers the Steadman factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. See WHX Corp. v. SEC, 362 F.3d 854, 859-61 (D.C. Cir. 2004); KPMG, 54 S.E.C. at 1192.

Act Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722, 61737; see also Alfred Clay Ludlum, III, Advisers Act Release No. 3628 (July 11, 2013), 2013 WL 3479060, at *1, 6; Johnny Clifton, Securities Act Release No. 9417 (July 12, 2013), 2013 WL 3487076, at *1, 13; Tzemach David Netzer Korem, Exchange Act Release No. 70044 (July 26, 2013), 2013 WL 3864511, at *1, 7.

Frank Lorenzo's conduct was egregious and repeated – he sent the violative email to two people. The conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of the conduct goes beyond a vigorous defense of the charges. His attempt to displace blame onto both Gregg Lorenzo and W2E is an aggravating factor. His chosen occupation in the financial industry will present opportunities for future violations. The violations were neither recent nor remote in time, having occurred about four years ago. The evidence of record does not quantify the degree of harm to the marketplace in dollars but harm is evident from the dishonest nature of Frank Lorenzo's misconduct. In light of these considerations, a cease-and-desist order is appropriate.

Frank Lorenzo's lack of a disciplinary history does not remove the need for sanctions. Mitchell M. Maynard, Advisers Act Release No. 2875 (May 15, 2009), 95 SEC Docket 16844, 6860 & n.39 ("[T]he absence of disciplinary history is not mitigative as securities professionals should not be rewarded for complying with securities laws.").

2. Civil Money Penalty

Section 21B of the Exchange Act authorizes the Commission to impose civil money penalties for willful violations of the Securities and Exchange Acts or rules thereunder. In considering whether a penalty is in the public interest, the Commission may consider six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. See Section 21B(c) of the Exchange Act; New Allied Dev. Corp., 52 S.E.C. 1119, 1130 n.33 (1996); First Sec. Transfer Sys., Inc., 52 S.E.C. 392, 395-96 (1995); see also Jay Houston Meadows, 52 S.E.C. 778, 787-88 (1996), aff'd, 119 F.3d 1219 (5th Cir. 1997); Consol. Inv. Servs., Inc., 52 S.E.C. 582, 590-91 (1996).

As to Frank Lorenzo, there are no mitigating factors. He violated the antifraud provisions, so his violative actions "involved fraud [and] reckless disregard of a regulatory requirement [and] created a significant risk of substantial losses to other persons" within the meaning of Section 21B of the Exchange Act. Deterrence also requires a substantial penalty against him.

Penalties are in the public interest in this case. Penalties in addition to the other sanctions ordered are necessary for the purpose of deterrence. See Section 21B(c)(5) of the Exchange Act; H.R. Rep. No. 101-616, at 17 (1990), reprinted in 1990 U.S.C.C.A.N. 1379, 1384. The Division requests that Frank Lorenzo be ordered to pay third-tier penalties, without specifying dollar amounts or units of violation. In addition to arguing that there were no violations, Respondent argues that civil penalties are not warranted, much less third-tier penalties. A third-tier penalty, as the Division requests, is appropriate because Frank Lorenzo's violative acts involved fraud and resulted in the risk of substantial losses to other persons. See Section 21B(b)(3) of the Exchange Act. Under that provision, for each violative act or omission during the time at issue the maximum third-tier penalty is $150,000 for a natural person. 17 C.F.R. § 201.1004. The provision, like most civil penalty statutes, leaves the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979).

The events at issue will be considered as one course of action, and a third-tier penalty amount of $15,000 will be ordered against Frank Lorenzo. Combined with the other sanctions ordered, a third-tier penalty of $15,000 – less than the maximum and equivalent to the actual loss sustained by investor Goolcharan – is in the public interest.

3. Bar

The Division requests that Frank Lorenzo be barred from the securities industry. Combined with other sanctions ordered, bars are in the public interest and appropriate deterrents. The violations involved scienter. Frank Lorenzo's business provides him with the opportunity to commit violations of the securities laws in the future. The record shows a lack of recognition of the wrongful nature of the violative conduct. His attempts to deflect blame onto others are aggravating factors. In short, it is necessary in the public interest and for the protection of investors that Frank Lorenzo be barred from the industry.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on November 26, 2013, plus Frank Lorenzo's Proposed Findings of Fact and Conclusions of Law, dated November 14, 2013.

VI. ORDER

IT IS ORDERED that, pursuant to Sections 8A of the Securities Act and 21C(a) of the Exchange Act, FRANCIS V. LORENZO CEASE AND DESIST from committing or causing any violations or future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IT IS FURTHER ORDERED that, pursuant to Section 21B of the Exchange Act, FRANCIS V. LORENZO PAY A CIVIL MONEY PENALTY of $15,000.

IT IS FURTHER ORDERED that, pursuant to Section 15(b) of the Exchange Act, FRANCIS V. LORENZO IS BARRED from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in an offering of penny stock.[12]

Payment of penalties shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange

[12] Thus, he will be barred from acting as a promoter, finder, consultant, or agent; or otherwise engaging in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, pursuant to Exchange Act Section 15(b)(6)(A), (C).

Commission. See 17 C.F.R. § 201.601(a), (c). The payment, and a cover letter identifying the Respondent and Administrative Proceeding No. 3-15211, shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., 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(h) of the Commission's Rules of Practice, 17 C.F.R. § 201.111(h). 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.

Carol Fox Foelak

Carol Fox Foelak
Administrative Law Judge

CFF
12/31/2013

EXHIBIT B

INITIAL DECISION RELEASE NO. 452
ADMINISTRATIVE PROCEEDING
FILE NO. 3-14340

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

In the Matter of	:	
	:	
GUALARIO & CO., LLC and	:	INITIAL DECISION
RONALD GUALARIO	:	February 14, 2012

APPEARANCES: Jack Kaufman, Alexander J. Janghorbani, and Ibrahim S. Bah for the Division of Enforcement, Securities and Exchange Commission

Ronald Gualario pro se and for Respondent Gualario & Co., LLC

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision (ID) concludes that Ronald Gualario (Gualario) and Gualario & Co., LLC (Gualario & Co.), violated the antifraud provisions of the federal securities laws by making material misrepresentations and omissions in the sale of promissory notes to investors and in the operation of a hedge fund. Additionally, Respondents acted as unregistered brokers. The ID orders Respondents to cease and desist from violations of the antifraud and registration provisions, to disgorge ill-gotten gains of $492,249.67, and to pay a civil money penalty of $390,000, and imposes broker-dealer, investment adviser, and investment company bars.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Proceedings (OIP) on April 8, 2011, 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(e), 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). The undersigned held a four-day hearing on September 12-15, 2011, in New York City.[1]

[1] The hearing session on September 14 was abbreviated. Tr. 407-13, 419-20. Respondents did not appear; a conference call that included the undersigned and counsel for the Division of

Seven witnesses testified, including Gualario, and numerous exhibits were admitted into evidence.[2]

The findings and conclusions in this ID are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the parties' Proposed Findings of Fact and Conclusions of Law and Respondents' Reply were considered. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

B. Allegations and Arguments of the Parties

This proceeding concerns Respondents' dealings with advisory clients during 2006 and 2007. The OIP alleges that they fraudulently sold promissory notes to clients, acted as an unregistered broker-dealer in their sale of limited partnership interests in real estate ventures, and failed to disclose a material change in their hedge fund investment strategy.

The Division of Enforcement (Division) is seeking a cease-and-desist order; disgorgement; a third-tier civil money penalty; and bars. Respondents argue that the charges are unproven and no sanctions should be imposed.

II. FINDINGS OF FACT

As discussed below, during 2006 and 2007, Respondents raised more than $8 million from the sale of promissory notes and limited partnerships in a hedge fund from their existing customers. By November 2007, the money had been spent or lost in trading, mostly in ways that were at variance to the representations made to the investors.

A. Respondents and Other Relevant Individuals

1. Respondents

Gualario graduated from Columbia College in 1990 and worked in the financial industry in various capacities for several years. Tr. 422-26. He founded Gualario & Co., an investment adviser, in February 1998, and has always been its owner, sole principal, president, and CEO.[3] Tr. 423, 426-28; Answer at 7. Gualario & Co. was registered with the Commission as an investment

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Enforcement was placed to Gualario's telephone number, and a summary of the phone call was placed in the record. Tr. 407-13.

[2] Citations to the transcript will be noted as "Tr. __." Citations to exhibits offered by the Division of Enforcement and by Respondents will be noted as "Div. Ex. __" and "Resp. Ex. __," respectively.

[3] Gualario has never been a registered broker-dealer or associated with one. Tr. 423.

adviser during the time at issue in 2006 and 2007.[4] Tr. 427. Its principal product was a discretionary large cap equity account, which emphasized S&P 500 stocks.[5] Tr. 430-31. During 2006 and 2007, these individually-managed accounts were held at TD Ameritrade. Tr. 433. In 2007, Gualario & Co. had over $40 million in assets under management. Tr. 438. Following the events at issue, Gualario & Co. shut down in approximately March 2008. Tr. 724.

As discussed below, starting in late 2006, Respondents raised money from existing clients via promissory notes and launched a hedge fund in August 2007.[6] Gualario & Co. was a one-man operation until late 2006. Tr. 428. Thereafter, Gualario hired a few staffers, including, in early 2007, a compliance officer, Sheng Fu Lin. Tr. 428-29. Nonetheless, Gualario remained the sole decision-maker on trades and provider of investment advice to clients. Tr. 138-39, 194, 433.

2. Sheng Fu Lin

As of January 1, 2007, Gualario hired as chief compliance officer Sheng Fu Lin (Lin), a CPA whose background included positions at the Commission, Morgan Stanley, and the Federal Reserve. Tr. 586, 640-41, 643-44; Resp. Exs. 77, 84, 87. Lin's last day at Gualario & Co. was September 14, 2007.[7] Tr. 586, 673; Resp. Ex. 140. Although claiming that Lin encouraged Gualario to trade options and take other risks, Gualario acknowledges that all decisions and representations were his responsibility. Tr. 672-90.

3. Thomas Genduso and Mortgage Bankers

Thomas Genduso (Genduso) is, and was at the time at issue, employed at Mortgage Bankers, a mortgage banking company; the company's two principals, Genduso and Edward Pozzuoli (Pozzuoli), each owned 50%. Tr. 112-14. Genduso and Gualario are cousins and had a close relationship in 2006. Tr. 114, 458. Genduso was also an advisory client of Gualario at that time. Tr. 451, 458. Genduso loaned Gualario substantial sums of money from time to time. Tr. 117, 132, 457, 459. Gualario testified evasively and inconsistently about these transactions – that they were gifts, loans, or not exactly loans, in that Gualario intended to repay the monies at some point, but Genduso never asked for specific repayments. Tr. 442-43, 457-61, 467-72.

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[4] Gualario believes that Gualario & Co. is no longer registered. Tr. 426-27; Answer at 7. However, according to the Commission's public official records, of which official notice is taken pursuant to 17 C.F.R. § 201.323, it has been, and still is, a registered investment adviser since 2006.

[5] Additionally, Gualario & Co. offered real estate holding accounts. Tr. 430.

[6] Until that time, Gualario & Co.'s clients had only separately-managed accounts. Tr. 429-430.

[7] Gualario testified that he did not realize that Lin had left permanently until a month later, when he noticed that Lin's office was vacant. Tr. 589, 676-77.

B. Promissory Notes

During the first half of 2006, Gualario & Co. earned approximately $380,000 in advisory fees. Answer at 8. However, the market value of its proprietary trading account dropped from approximately $262,000 at the end of June 2006 to approximately $162 at the end of July 2006, and it had to meet a margin call of approximately $20,000 in its proprietary trading account. Tr. 441-42; Div. Ex. 25 at SEC-NY-7870-006017; Answer at 8. At that time, Gualario borrowed $25,000 from Genduso. Tr. 442-43. Also around that time, Gualario started recommending to his clients the purchase of promissory notes in Gualario & Co. Tr. 443-46.

1. Phyllis Wilson

Phyllis Wilson (Wilson) became a client of Gualario in 2002. Tr. 444, 611-13; Resp. Exs. 101, 102. Wilson trusted Gualario and considered him a friend. Tr. 32-34, 51, 54, 70-71, 86, 98, 103-04. In February 2007, she even made a health care power of attorney naming Gualario as her agent to make health care decisions for her, gave him a general power of attorney to take effect in the event of her disability, and created a living trust, naming him as successor trustee on her death. Resp. Exs. 1, 2, 3, 4, 5. In an accompanying handwritten note expressing her "Life/Death Wishes," she wrote, "I trust you and believe in you!" Resp. Ex. 4. As a result of the events at issue, her attitude changed drastically; when cross-examined by Gualario, she testified: "I trusted you. And you lied to me." Tr. 103.

In 2006, Wilson, then aged 63, retired as a teacher. Tr. 30-31, 445-46. Almost all of her money was invested with Gualario. Tr. 33-34. Gualario was aware of the extent of her assets and knew that she was not a sophisticated investor and that she relied on his advice. Tr. 445-48. Invested in stocks before her retirement, Wilson became concerned with the fluctuation of the stock market and desired, instead, a fixed monthly income. Tr. 32-35, 44-45, 68, 447-50. Gualario suggested a promissory note. Tr. 34-35, 68-70. Wilson expected the note to be issued by Gualario or Gualario & Co. but, when she received the documentation, found Mortgage Bankers to be the issuer. Tr. 35-44, 72-73, 77; Div. Exs. 12, 13. Gualario, however, told her he would assume the note.[8] Tr. 39, 110, 474. Gualario's reason for substituting Mortgage Bankers was that he was not in a position to pay the interest on the note. Tr. 471, 613-14. The record does not show that Wilson understood the significance of this. Tr. 39, 65, 72-73, 471. Wilson signed the Mortgage Bankers promissory note and Gualario & Co.'s form titled "Self-Directed Investment Authorization Non-Publicly Traded Investments"[9] on July 27, 2006. Tr. 37, 454, 457-59, 461; Div. Ex. 12, Div. Ex. 13 at SEC-NY-7870-004750. In early August, Gualario arranged for the transfer of $100,000 from

[8] He never did so. Tr. 479, 619.

[9] This form represented, falsely, that Gualario & Co. had no business relationship with Mortgage Bankers. Tr. 457-58. Div. Ex. 12. Gualario testified that the document essentially was boilerplate; he did not review its accuracy before it was sent to a customer. Tr. 454-57. Wilson did not read this or any other document Gualario provided for the notes in which she invested because she trusted him and because, in her words, "[she] was stupid." Tr. 51, 53-55, 76.

Wilson's Gualario & Co. account to Mortgage Bankers. Tr. 114, 453-57; Div. Exs. 12, 13, 143. Gualario did not tell Wilson that he was going to use her money to pay a debt he owed Genduso. Tr. 42, 110. Wilson did not realize until too late, when she was not receiving interest payments, that Gualario was in financial trouble. Tr. 65, 78-79.

When Mortgage Bankers received Wilson's $100,000 on August 7, 2006, Genduso understood the payment was intended to satisfy a debt of about $50,000 that Gualario owed Genduso. Tr. 116-17. Genduso retained $50,000 and gave the remaining $50,000 to Gualario.[10] Tr. 117. Genduso received Wilson's Mortgage Bankers note on August 9, 2006, a few days after receiving the $100,000. Tr. 119; Div. Exs. 18, 144. Mortgage Bankers had never previously issued a promissory note.[11] Tr. 121-22. Genduso instructed Gualario "to take care of" the note; Gualario responded that he, not Mortgage Bankers, was responsible for the note and that he would "take care of it." Tr. 122-23. Genduso never considered the document to be a genuine, authorized promissory note issued by Mortgage Bankers. Tr. 124, 129. Genduso made at least two payments, totaling $2,000, to Wilson at Gualario's request. Tr. 128-29, 618-19; Div. Ex. 14. Genduso placed the note, which had a line for his signature, in his cabinet; he signed it sometime later, at the request of Gualario, who said that the signature was a necessary technicality.[12] Tr. 125, 473-74; Div. Exs. 17, 18. Genduso never told his partner, Pozzuoli, about the matter. Tr. 117, 123, 133-36.

Wilson invested an additional $340,000 in promissory notes of Gualario & Co. between September 2006 and January 2007. Tr. 44-55, 622-23; Div. Exs. 50, 56, 57, 58, 59, 60. She had no idea of the purposes for which the funds were to be used. Tr. 101-02.

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[10] Gualario denies that Genduso personally retained $50,000 of the $100,000 but admits that Genduso returned $50,000. Tr. 467-68. Gualario's alternative explanation concerning the $50,000 that was not returned is convoluted, contradictory, and hard to follow, for example that his intended future assumption of the $100,000 note "would have been repayment of the [$50,000] gift." Tr. 467-72. Since Genduso had knowledge of his own actions, and Pozzuoli, Genduso's sole partner in Mortgage Bankers, knew nothing of the matter, Mortgage Bankers cannot have received the benefit of the $50,000 that was retained. Tr. 134-36. Since any other explanation makes no sense, it is found that Genduso retained $50,000.

[11] Genduso testified that, prior to receiving the note, he knew nothing about it. Tr. 121-22. Gualario testified that Genduso authorized him to issue the note in the name of Mortgage Bankers. Tr. 467, 471, 613-14. This conflict in the evidence, however, is not material to any issue in this proceeding.

[12] Genduso's signature line is blank on the copy provided to Wilson. Tr. 40-41; Div. Ex. 13. Genduso testified that he signed years later, while Gualario testified that Genduso signed at an unspecified earlier time. Tr. 125, 473-74. Genduso provided to Commission staff a copy of the note without a signature page on November 19, 2010; after a further request, he provided a signed version. Tr. 126-28; Div. Exs. 17, 18. The date when Genduso signed the note, however, is not material to any issue in this proceeding.

Wilson received some interest payments but lost the entire principal, $440,000, that she had invested with Gualario. Tr. 55-56, 63, 65-66, 74, 76-77, 105-06, 480; Div. Ex. 137. At one point in 2008, Wilson travelled to New York City to meet with Gualario in the hope that he would pay her money that she was owed; he gave her some post-dated checks, but they bounced. Tr. 57-59, 81, 106; Div. Exs. 136, 138. As a result of the loss of her capital, Wilson had to sell her house, move to a rundown apartment, and ask her cousins for money to help support her mother, who lives with her. Tr. 66. She also returned to teaching; she substitute teaches almost every day that school is in session. Tr. 66.

2. Gualario & Co. Promissory Notes

In early September 2006, Gualario & Co. had approximately $7,000 in its business account and had issued several checks that bounced. Tr. 503-04. Starting around that time, Gualario solicited and obtained investments, from existing clients, in Gualario & Co. promissory notes to raise funds that he represented would be used to launch a hedge fund. Div. Exs. 31-42, 44-78. Letters from Gualario to these clients enclosing offering documents and paperwork stated, "As we discussed, this offering will allow me to put in place the proper infrastructure needed to successful [sic] transition part of our business to a hedge fund model." Div. Exs. 31-39. The subscription agreements executed by the investors stated:

> [Gualario & Co.] is in the process of transitioning a portion of its . . . business to a hedge fund model . . . . [This] will require [Gualario & Co.] to, incur significant legal and accounting fees, increase staffing (including Chief Compliance Officer and Chief Financial Officer, both of which positions are presently held by Ronald Gualario), retain an outside hedge fund administrator and relocate to a larger office space. [Gualario & Co.] will use the proceeds of the Offering to meet the expenses related to the above requirements and to provide it with additional working capital.

Div. Exs. 66-78. Gualario stated in the initial solicitation, "I anticipate the official launch of the [hedge fund] on December 29, 2006." Div. Exs. 31-38.

Gualario also made oral representations concerning the notes to clients. Tr. 445. For example, he approached Zachary Goldman (Goldman)[13] in August 2006 about investing in the notes. Tr. 138-40. Gualario told Goldman that he had $45 million under management, that he wanted to establish a hedge fund, for which clients had already committed $7 million, that he needed to move his office and hire staff to launch the fund, and that he needed $500,000 to do this.[14] Tr. 141. Gualario represented to Goldman and other investors that the proceeds from the

[13] Goldman was a client of Gualario & Co. from 2004 to 2008. Tr. 138-39. Aged 78 during the time at issue, Goldman had previously retired as a chief financial officer of a corporation. Tr. 137-38. He resumed employment in February 2009; from January through April 15, he does tax returns for H&R Block, and from September through December, he substitute teaches in Palm Beach County, Florida, high schools. Tr. 137-38.

[14] Gualario explained that the hedge fund would be conservatively managed; he would continue his long equity position strategy hedged with a short position of about 20%. Tr. 144.

notes were to be used for these purposes only. Tr. 142, 199-202, 510-518; Div. Exs. 31-39, 66-78. The proceeds were not to be used for trading. Tr. 170-71. Gualario did not tell Goldman that he would use the proceeds from the notes to trade options for Gualario & Co.'s own account. Tr. 142, 171. Goldman was concerned that Gualario did not have $500,000 on hand, but Gualario reassured him on this point. Tr. 141. Gualario did not disclose anything about the financial condition of Gualario & Co. or about his own financial condition, although he emphasized that the notes would have his personal guarantee, which influenced Goldman's decision to invest.[15] Tr. 142-46. Gualario explained that the notes would be for a two-year term, but that he expected to launch the hedge fund within a short time. Tr. 141-42. Goldman decided to invest $50,000 in a note. Tr. 144; Div. Exs. 32, 41, 51, 67. Although Goldman scanned the subscription agreement, he did not read it carefully because he trusted Gualario. Tr. 147-48, 172. Goldman received interest payments due through 2007, although the payments due for the last several months of 2007 were paid in early 2008; then the payments stopped, and the principal was not repaid. Tr. 150-51.

Ronald Rapuano (Rapuano) [16] also invested $100,000 in a promissory note. Tr. 197; Div. Ex. 54. Gualario told him the proceeds were to be used as start-up money to develop the Fund. Tr. 199-202; Div. Exs. 31, 47. Rapuano never received any repayment of principal on the note.[17] Tr. 202.

The proceeds from the first group of promissory notes were $490,000. Tr. 499. Much of that sum was exhausted by the end of November 2006.[18] Div. Exs. 23, 25. About $300,000, rather

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[15] Gualario's explanation for the reason for the personal guarantee was that he would be taking distributions from the accounts. Tr. 511, 653.

[16] Rapuano, an oral surgeon, retired in 2006. Tr. 190-91. He was a client of Gualario & Co. from early 2005 until relatively recently. Tr. 194. He also was on a friendly basis with Gualario. Tr. 194-95, 227. After observing Gualario's handling of a small portion of his assets, he placed a larger account under Gualario's control. Tr. 196.

[17] Rapuano testified that he never received any interest payments on the note. Tr. 202. Gualario argues that interest payments were made, and the record contains several Gualario & Co. checks payable to National Investor Services Corp. f/b/o Ronald Rapuano (No. 1178, $1,227.40, paid December 15, 2006; No. 1199, $1,358.90, paid January 23, 2007; No. 1230, $1,358.90, paid March 30, 2007; No. 1269, $1,227.40, paid April 11, 2007; No. 1004, $1,358.90, paid May 10, 2007). Div. Ex. 23 at SEC-NY-7870-007966, -007997, -008009, -008029, -008091, -008105, -008131, -008169, Div. Ex. 24 at SEC-NY-7870-008193, -008225. There is no evidence in the record tying the payments to the note (or illuminating their purpose in any way), and the sums paid are not congruent with the amounts due Rapuano. The $100,000 note had an interest rate of 16%, payable monthly. Div. Ex. 54. Thus, monthly payments of the $16,000 in interest due annually would have been $1,333.33. Nonetheless, to the extent there is any conflict in the record concerning interest payments to Rapuano, it is not material to any issue in this proceeding.

[18] Division Exhibit 133e, a summary exhibit, erroneously reports the balance in Gualario & Co.'s Chase Business accounts on November 20, 2006, as $9,282.69. Review of the account

than being spent on launching the hedge fund, was transferred into Gualario & Co.'s TD Ameritrade proprietary trading account and lost in trading options. Tr. 521-22, 527-28, 539, 635; Div. Exs. 20, 23, 25. Gualario was "in a jam." Tr. 530. Accordingly, a second set of notes was sold from November 28, 2006, to March 22, 2007, which yielded proceeds of $390,000.[19] Div. Exs. 23, 56-61, 148. A portion of that sum was transferred to Gualario & Co.'s trading account. Div. Exs. 23, 25. This was also used for options trading. Tr. 635. Additional notes were sold between April 5 and July 27, 2007, yielding $240,000. Div. Exs. 20, 23, 24, 25, 62, 64, 65. Of the total raised up to that point, $1.12 million, Gualario has repaid $130,000.[20] Tr. 539, 669; Resp. Ex. 120. Thus, disregarding unpaid interest, his clients lost $990,000 invested in the notes.[21]

3. Gualario's Use of the Proceeds from the Notes

There is no doubt that Gualario spent <u>some</u> of the proceeds on expenses related to launching the fund, such as professional services, computers, increased rent, and staff. Resp. Exs. 70, 71, 74, 75, 76, 82. Gualario's own list of one-time expenses amounted to $539,000, and that sum is accepted as the amount spent to launch the fund. Resp. Ex. 89. A detailed list shows that $1.04 million was spent from September 2006 until the end of 2007 on various specified categories, but half of the list, including such items as charitable giving, auto expenses, liquor, and restaurants, was irrelevant to starting the hedge fund, and the time frame was too long, far beyond the December 2006 launch date specified in the offering materials and the actual launch date in August 2007. Tr. 174-78; Resp. Ex. 95. Such expenditures were at variance with what Goldman understood from Gualario's representations on how the proceeds would be used. Tr. 174-78.

Gualario gave Lin access to all of the firm's data, including the notes, and told him to review everything the firm had done. Tr. 588, 680. However, he did not tell Lin how he had spent the proceeds of the notes. Tr. 588.

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statements for the period November 1-30, 2006, shows the correct figure to be $92,782.69. Div. Ex. 23 at SEC-NY-7870-007954 - 007963. The incorrect figure is also referenced in another summary exhibit, Division Exhibit 133g. The undersigned has not relied on Division Exhibits 132 or 133a through 133h.

[19] Inconsistently and illogically, Gualario denied that he sold additional notes to make up for the approximately $300,000 of the first offering that he lost in trading. Tr. 533. (His alternative explanation was that he realized that launching the fund would cost $1 million rather than $500,000. Tr. 529-30.)

[20] Subsequently, note-holder Thomas G. Colacino (Colacino) invested an additional $50,000 in a promissory note on November 2, 2007. Tr. 669; Resp. Ex. 120 at 1 and Ex. C. On February 13, 2008, Gualario paid Colacino $200,000, which included $130,000 in principal of his original notes, $50,000 in principal of the November 2, 2007, note, and $20,000 in interest. Tr. 669; Resp. Ex. 120 at 1.

[21] Gualario acknowledged that this value is correct. Tr. 669.

4. **What Did Gualario Tell Clients?**

As found above, Gualario told clients that the proceeds of the notes would be used only to launch the hedge fund. When soliciting clients for the first set of notes, Gualario did not disclose Gualario & Co.'s parlous financial condition. Tr. 142-46, 504-05. When soliciting clients for subsequent rounds of notes, he did not tell them that he had lost a portion of the funds raised from preceding rounds of notes through proprietary trading in options. Tr. 539. He has no specific memory of discussing the losses with anyone who invested in any of the notes. Tr. 539.

Gualario testified that it was his intent to use the proceeds of the notes to launch the hedge fund, not to trade options. Tr. 649. While this may have been his state of mind before he issued the first set of notes, his claimed intent is less believable as to the second set, which was issued after much of the proceeds of the first set were lost in options trading.

C. Gualario SPX Select Fund, LP

Gualario & Co. launched the hedge fund, Gualario SPX Select Fund, LP (the Fund), in August 2007. Tr. 438-39; Answer at 7, 8. Gualario Capital Partners, LLC (Gualario Capital Partners), of which Gualario was the Managing Member and sole owner, was the general partner; the limited partners were five pre-existing advisory clients of Gualario & Co. Tr. 439-40, 545, 568; Answer at 7, 8. Respondents raised $7.1 million for the Fund from the five clients. Answer at 7. Gualario made all investment decisions for the Fund. Tr. 439. Gualario told the clients that he would use a strategy similar to that of his existing large cap equity accounts, with the addition of some short selling, referred to as a long/short U.S. equity large cap strategy. Tr. 545-63. A PowerPoint presentation that was provided to clients stated:

> The Fund will take both long and short equity positions of select companies in the S&P 500 Index. . . . The investment strategies implemented for the Fund by Gualario & Co. will be an expansion of the investment strategies it uses for its Large-Cap Equity Composite. . . . Some of its risk management guidelines include: employment of adequate portfolio diversification to eliminate excess volatility; taking short positions as the preferred method for hedging a portfolio's systematic risk; and employment of stop loss measures. . . . The Fund is expected to generate better and more consistent returns than Gualario & Co.'s Large-Cap Equity Composite through the combination of its existing large-cap equity strategy and taking short positions, which essentially provide a natural hedge to the inherent market risk. This hedged profit is expected to generate greater Alpha with lower volatility.

Tr. 212-13; Div. Ex. 89 at 3, 7, 8. Gualario & Co.'s August 9, 2007, press release announcing the Fund's launch quoted Gualario: "As our primary focus remains asset protection, the Fund will provide a vehicle for our clients to earn consistent returns regardless of market direction and volatility as they benefit from our proven expertise in large-cap equity while being hedged against systemic risk." Div. Ex. 96.

Rapuano invested in the Fund. Tr. 196, 203; Div. Ex. 90. In reading the private placement memorandum, Rapuano noted that the discussion of risk factors, derivatives, leverage, and options trading suggested that the Fund was intended to be speculative; Gualario reassured him that this was boilerplate, that the Fund was not going to be highly speculative, and that the real risk was negligible.[22] Tr. 205-11, 218, 238-39; Div. Ex. 90. Gualario said his intention was to have the same strategy he used previously in the individually-managed accounts, with the addition of selling short. Tr. 210-11. Rapuano would not have invested his money in a highly risky venture. Tr. 211. Rapuano had discussed his assets with Gualario. Tr. 212, 216-17. He was concerned about the safety of his money in retirement. Tr. 218. Subsequently, Rapuano met in person with Gualario, who showed him the PowerPoint presentation. Tr. 212-13; Div. Ex. 89. Rapuano invested approximately $740,000 in the Fund in late July or early August 2007. Tr. 215; Div. Ex. 99. That sum was about 20% of his assets and at least 40% of his liquid assets. Tr. 216. At that point, Gualario was in control of about two-thirds of Rapuano's liquid assets. Tr. 216.

In August 2007, as promised, the Fund traded exclusively long and short positions in common stock of large cap U.S. companies; it made a profit of approximately 9%. Tr. 323-24, 572. During September 2007, the Fund's risk profile increased as its position sizes became larger. Tr. 300-01, 321. In September, it incurred a loss of approximately 20%. Tr. 575. The Fund was profitable until a $1.7 million loss on September 18. Tr. 305; Div. Ex. 127 at 6-7. Starting on September 24, 2007, the Fund changed from investing entirely in equities to investing almost exclusively in highly-speculative and extremely risky short-dated equity options.[23] Tr. 310-11, 326-27. Gualario did this, not as part of a hedging strategy, but because the Fund had little capital left following a massive losing day trade. Tr. 581-82. Gualario considered the option trading risky, with the Fund taking million dollar swings every few days. Tr. 582-83. He also abandoned any risk management measures, took overweighted positions in the Fund, and borrowed excessively on margin.[24] Tr. 584-85. This was not the strategy that Gualario had told investors that he was going

[22] In his Reply pleading and elsewhere, Gualario points to the boilerplate language as disclosure that the Fund could engage in trading in "a broad range of financial instruments, securities and transactions, including, without limitation, options, fixed income, derivatives, swaps, convertible securities of U.S. and non-U.S. issuers and other instruments" and "utilize a variety of investment techniques including, but not limited to, short selling, purchase and sale writing of options on securities (both covered and naked options), and the use of borrowed funds for investment purposes (i.e., leverage)." Div. Ex. 90 at SEC-NY-7870-005492.

[23] Short-dated options – options that will expire shortly – have a higher risk/return profile when their strike price is close to the price of the underlying common stock. The risk is that they will expire worthless, with the loss of the premium, in a short time. Because of the short time, very small changes in the stock price will determine whether they are valuable or worthless. Tr. 324-25. Div. Ex. 127 at 5-6.

[24] As the Division's expert witness, Brian Fitzpatrick, noted and Gualario acknowledged, the Fund's positions were overweighted and insufficiently diversified, which increased the risk that losses on short-dated equity options trading would prove catastrophic. The large position sizes magnified the overall risk of the equity options trades. Div. Exs. 113, 127, 128, 130, 131.

to use for the Fund. Tr. 583-84. By the end of October, the Fund had lost 98% of its value.[25] Tr. 583-85. For October, the Fund received about $10,250 in management fees. Tr. 585; Answer at 13. The Fund collapsed in October 2007 and ceased operations in 2008. Answer at 8.

When Rapuano noted a 20% drop in the value of the Fund on reviewing his account statement for September 2007, he telephoned Gualario who assured him that it was a minor problem that would be resolved in the following month; Gualario said nothing about trading options, changing his trading strategy, or engaging in a more risky trading strategy. Tr. 218-21. On October 31, 2007, Rapuano learned that the account had lost 98% of its value. Tr. 221-24; Div. Ex. 113. In sum, he lost most of the money he invested in the Fund and the $100,000 he invested in the note. Tr. 224. As of the time of the hearing, Rapuano had not received any restitution for his losses. Tr. 286-87. If Gualario refunded his losses, Rapuano probably would be willing to invest with him again. Tr. 253.

D. Gualario Regrets Causing His Customers' Losses

When Gualario established the Fund, he intended a long/short equity strategy and did not intend to trade options. Tr. 546-47, 685. Gualario did not personally profit from the events at issue; rather, he perceives the destruction of his business as a grievous loss. Tr. 663-65. Gualario repeatedly recognized the financial harm to customers that his actions have caused and his responsibility for their losses. Tr. 700, 703, 726; Div. Ex. 113. He hopes to pay the customers the money they lost. Tr. 667, 725. He has made this hope concrete in a written instrument that has been conveyed to the Fund investors. Tr. 246, 286-87; Resp. Ex. 112. However, he has not repaid any money as yet. Tr. 287.

In an e-mail sent to Fund investors on October 31, 2007, informing them that the Fund had lost 98% of its value, Gualario stated "I understand full well my fiduciary responsibilities to you and recognize that I failed you . . . ." Div. Ex. 113. He admitted:

> [t]he fund was intended to be conservative in nature, utilizing a disciplined and well thought out long/short investment strategy. . . . During [October] our risk management measures went by the wayside, with particular positions over-weighted, utilization of excessive margin, derivatives left uncovered, and a portfolio that resembled nothing like our investment model.

Id.

Gualario verbalizes that the conduct at issue was his responsibility. Tr. 433, 682, 689, 702. However, he also insinuates that Lin and Merlin Securities, LLC (Merlin Securities), Gualario & Co.'s introducing prime broker, share responsibility. Tr. 433, 516, 633-36, 642, 673, 680, 689, 702.

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[25] The largest contributor to the Fund's losses in October was the purchase from October 17 to 19 of a series of put options of Google common stock, many of which expired worthless on October 19. Tr. 325, 327; Div. Ex. 127 at 9-10. The Fund lost over $6 million on these trades, reducing its available capital to nearly zero. Tr. 326.

While Gualario insinuates that Lin was at least partly responsible for any violations, Lin was not employed at Gualario & Co. during 2006, when most of the notes were sold to customers. Further, while Gualario claims that Lin did not object to Gualario's use of the proceeds from the notes, there is no evidence in the record that Lin knew how Gualario was using the proceeds. Concerning the Fund, Lin had left Respondents' employment on September 14, 2007, before Gualario's final risky option trading. Also concerning the Fund, Gualario blamed Merlin Securities for encouraging him to overspend on new offices and to keep trading risky options.

E. Real Estate

In addition to the discretionary large cap accounts, Gualario & Co. had non-discretionary (investment decisions made by the investor, not by Gualario) accounts that held non-publicly traded real estate holdings.[26] Tr. 430, 590. Respondents facilitated transactions in these accounts by effecting the sale of securities of several issuers to clients. Tr. 593-95; Div. Ex. 119. Gualario & Co. did not receive performance-based fees for these investments.[27] Div. Exs. 119, 123. Rather, it received one-time transaction-based fees equal to the lesser of 1% of the amount invested or $1,000. Tr. 151-55, 590-91; Div. Ex. 123. Gualario provided investment advice to clients, when asked, concerning real estate investments. Tr. 596-97. Goldman is grateful for Gualario's advice, which helped him to avoid losses. Tr. 152, 159-61; Resp. Ex. 22.

Gualario maintains that he was told by a regulatory official that he could assist clients in the manner at issue here without registering with the Commission as a broker-dealer: he testified that he telephoned officials at the Commission and the NASD concerning this. Tr. 710-17; Resp. Exs. 50, 51, 52. Further, he testified that he does not remember details, but came away from a conversation with somebody, perhaps Afshin Atabaki (Atabaki) of the NASD's general counsel's office, with the feeling that he could facilitate real estate transactions in the manner at issue without registering as a broker-dealer. Tr. 710-17; Resp. Ex. 52. However, Atabaki does not remember this, and, further, the NASD's policy, now published on the website of its successor organization, FINRA, was to provide interpretive guidance relating to its own rules only (that is, not relating to statutes or Commission rules). Tr. 331-39; Div. Ex. 150. The Commission's records reflect calls from Gualario on November 22, 1999, and January 10, 2001, but neither of the calls concerned the type of conduct at issue.[28] Tr. 420-21; Div. Exs. 145, 146, 151. In sum, the record does not support

[26] Both Goldman and Rapuano had real estate investments through Gualario. Tr. 152, 159-61, 225-26; Div. Ex. 123.

[27] Gualario & Co. received performance-based fees for its discretionary large cap accounts. Tr. 433-38.

[28] The 1999 call concerned his connecting, for a percentage fee, investors with an Italian bank that was issuing bonds; Gualario was told he would probably be required to register. Div. Ex. 145, 151. Gualario withdrew from involvement in the transaction. Tr. 712. The 2001 call concerned his bringing two broker-dealer parties together, for a fee, with reference to some kind of securities issued by Deutsche Bank; he was told he would probably be required to register. Div. Exs. 146, 151. Gualario believes that the Commission's record of this call does not include

Gualario's contention, and it is found that he was not advised by anyone at the NASD or the Commission that he could assist clients in the manner at issue here without registering as a broker-dealer.

The OIP alleges that, from at least January 2006 through October 2007, Respondents received at least $89,000 in transaction-based fees for facilitating real estate investments. The Division contends that, between January 2006 and July 2008, Respondents received $145,624.17 in such fees, describing them as "single day fees," consisting of $33,000 in fees equal to $1,000, $37,153.18 in fees under $1,000, and $75,470.99 in fees over $1,000. Div. Ex. 134.[29] In his Reply, Gualario argues that approximately $25,000 to $45,000 is attributable to real estate transaction fees, but he does not point to any evidence of record to support this argument. Gualario & Co.'s TD Waterhouse and TD Ameritrade account statements show $31,000 in single day fees equal to $1,000 received from January 2006 through October 2007, the period alleged in the OIP. Tr. 590-93; Div. Ex. 25. It is found that fees of exactly $1,000 are more likely than not to be real estate transaction fees. Single day fees that individually exceed $1,000 cannot be real estate transaction fees, which were capped at $1,000. Of the remaining category – single day fees under $1,000 – while all could theoretically be real estate transaction fees, many are values, such as $16.59 or $73.59, that are unlikely to be such fees, and there is no additional evidence of record that shows the purpose of each credit to Gualario & Co.'s account. Accordingly, it is found that Gualario & Co. received $31,000 in transaction-based fees for real estate investments from January 2006 through October 2007.

F. Ability to Pay

In testimony concerning his desire to repay investors, Gualario stated, "I am broke, basically, right now." Tr. 725. However, he has not otherwise asserted an inability to pay disgorgement, interest, or penalties. Nor has he introduced evidence to support such an assertion. Accordingly, Gualario has not demonstrated an inability to pay any disgorgement, interest, or penalties that may be ordered in this proceeding.

III. CONCLUSIONS OF LAW

The OIP charges that Respondents willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act. Additionally, it charges that Gualario & Co. willfully violated and Gualario caused and willfully aided and abetted Gualario & Co.'s violation of Section 206(4) of the Advisers Act and Rule 206(4)-4(a)(1) thereunder. Finally, it charges that Respondents violated the broker-dealer registration provision, Section 15(a)(1) of the Exchange Act. As discussed below, it is concluded that they willfully violated those provisions.

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an additional topic that was not resolved – his role in the real estate transactions – and that eventually it was resolved by his conversation with Atabaki. Tr. 714-16.

[29] Division Exhibit 134, a summary exhibit, has not been relied on except as a guide to the Division's contentions.

A. Antifraud Provisions

Respondents are charged with willfully violating the antifraud provisions of the Securities, Exchange, and Advisers Acts – Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act – which prohibit essentially the same type of conduct. United States v. Naftalin, 441 U.S. 768, 773 n.4 & 778 (1979); SEC v. Pimco Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004).

Section 17(a) of the Securities Act makes it unlawful "in the offer or sale of" securities, by jurisdictional means, to:

> 1) employ any device, scheme, or artifice to defraud;
>
> 2) obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary to make the statement made not misleading; or
>
> 3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Similar proscriptions are contained in Exchange Act Section 10(b) and Rule 10b-5 and in Advisers Act Sections 206(1), 206(2), and 206(4).

Scienter is required to establish violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1). Aaron v. SEC, 446 U.S. 680, 690-91, 695-97 (1980); SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is "a mental state embracing intent to deceive, manipulate, or defraud." Aaron, 446 U.S. at 686 n.5; Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976); SEC v. Steadman, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. See David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); SEC v. Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is "conduct which is 'highly unreasonable' and represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)).

Scienter is not required to establish a violation of Section 17(a)(2) or 17(a)(3) of the Securities Act or of Section 206(2) or 206(4) of the Advisers Act; a showing of negligence is adequate. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); SEC v. Steadman, 967 F.2d at 643 & n.5; Steadman v. SEC, 603 F.2d 1126, 1132-34 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

Gualario & Co. is accountable for the actions of its responsible officer, Gualario. See C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988) (citing A.J. White & Co. v.

SEC, 556 F.2d 619, 624 (1st Cir. 1977)). A company's scienter is imputed from that of the individuals controlling it. See SEC v. Blinder, Robinson & Co., Inc., 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)). As an associated person of Gualario & Co., Gualario's conduct and scienter are also attributed to the firm. See Section 203(e) of the Advisers Act.

Material misrepresentations and omissions violate Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1), 206(2), and 206(4). The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not 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); SEC v. Steadman, 967 F.2d at 643.

Gualario, as owner, sole principal, president, and CEO of Gualario & Co., was an associated person of an investment adviser. See Advisers Act Sections 202(a)(17), 203(f). Investment advisers and their associated persons are fiduciaries. Fundamental Portfolio Advisors, Inc., Securities Act Release No. 8251 (July 15, 2003), 56 S.E.C. 651, 684; see Capital Gains Research Bureau, Inc., 375 U.S. at 191-92, 194, 201; see also Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979). As such, investment advisers and their associated persons are held to a higher standard than broker-dealers and their associated persons.

An associated person may be charged as a primary violator, where, as here, the investment adviser is an alter ego of the associated person. John J. Kenny, Securities Act Release No. 8234 (May 14, 2003), 56 S.E.C. 448, 485 n.54. Accordingly, as discussed below, the undersigned has concluded that Gualario violated Section 206(4) of the Advisers Act and Rule 206(4)-4(a)(1). Thus, it is unnecessary to address his secondary liability for violating those provisions.

In addition to requesting a cease-and-desist order pursuant to Sections 8A of the Securities Act, 21C(a) of the Exchange Act, and 203(k) of the Advisers Act and disgorgement pursuant to Sections 8A(e) of the Securities Act, 21C(e) of the Exchange Act and 203(j) of the Advisers Act, the Division requests sanctions pursuant to Sections 15(b) and 21B of the Exchange Act, 203(e), 203(f), and 203(i) of the Advisers Act, and 9(b) of the Investment Company Act. Willful violations by Respondents must be found in order to impose sanctions on them pursuant to Sections 15(b) and 21B of the Exchange Act, 203(f) and 203(i) of the Advisers Act, and 9(b) of the Investment Company Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d at 1135; Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

B. Antifraud Violations

The record shows that Respondents violated the antifraud provisions by making material misstatements and omissions in the sale of the "Mortgage Bankers" note to Wilson, the sale of the Gualario & Co. notes, and the radical change in strategy in the Fund that was inconsistent with what clients were told when they invested and not disclosed to them subsequently.

When he sold Wilson the $100,000 "Mortgage Bankers" note, Gualario knew that she was financially unsophisticated, that she trusted him and relied on his advice, and that she could ill-afford to lose her limited capital. Yet, although he knew that he was unable to pay the interest on the note, when she asked him why Mortgage Bankers was the issuer, he reassured her by saying that he would assume the note. Also, he did not tell her that $50,000 of the proceeds was used to pay off a debt to Genduso. Further, he provided her with a form that represented falsely that Gualario & Co. had no business relationship with Mortgage Bankers. The fact that she did not read the form does not excuse his action in making the false representation. His actions show at least a reckless degree of scienter – highly unreasonable and an extreme departure from the standards of ordinary care – and a clear violation of the fiduciary duty owed by an investment adviser.

The Gualario & Co. notes were sold to investors with the representation that the proceeds would be used to launch the Fund. That representation was false. Even though a portion of the proceeds was used to launch the Fund, a substantial portion was devoted to other expenditures or lost in risky options trading. Further, Respondents did not tell investors in the second set of notes that a substantial portion of the proceeds of the first set had been lost in trading.[30] These misrepresentations and omissions were clearly material and made with at least a reckless degree of scienter.

While Respondents operated the Fund in accordance with representations made to investors for the first few weeks of its short life, they abandoned risk management completely on September 24, 2007, and changed from investing entirely in equities to investing almost exclusively in highly-speculative, extremely risky, short-dated equity options, took overweighted positions, and borrowed heavily on margin, resulting in losses that reduced the Fund's value, from about $6 million to close to zero by the end of October. The materiality of the change from the strategy represented to investors is shown by the fact that the Fund was essentially wiped out in one month. While Gualario points to boilerplate language in the offering materials allowing almost any type of investment, the thrust of the representations to investors is that the Fund would use a strategy similar to that of the existing large cap equity accounts, with the addition of some short selling. His total departure from that strategy in the face of limited losses in September made his previous representations materially misleading. Again, his actions show at least a reckless degree of scienter.

C. Registration Provision

Section 15(a)(1) of the Exchange Act makes it unlawful for any entity to effect transactions in securities, by jurisdictional means, without registering as a broker or dealer, or, if a natural person, without being associated with a registered broker or dealer. "Broker" is defined 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." 15 U.S.C. § 78c(a)(4). Scienter is not required to establish a violation of this provision. SEC v. Montana, 464 F. Supp. 2d 772, 785 (S.D. Ind. Nov. 22, 2006).

[30] Under the circumstances, this failure in itself violated Advisers Act Rule 206(4)-4, which was in effect during the relevant period.

Activities of a broker are characterized by "a certain regularity of participation in securities transactions at key points in the chain of distribution." Massachusetts Fin. Servs., Inc. v. Sec. Investor Prot. Corp., 411 F. Supp. 411, 415 (D. Mass. Mar. 26, 1976), aff'd 545 F.2d 754 (1st Cir. 1976). Other factors that are relevant in determining whether an individual acted as a broker include whether the individual: "1) is an employee of the issuer; 2) received commissions as opposed to salary; 3) is selling, or previously sold, the securities of other issuers; 4) is involved in negotiations between the issuer and the investor; 5) makes valuations as to the merits of the investment or gives advice; and 6) is an active rather than passive finder of investors." SEC v. Zubkis, 2000 WL 218393 at *9 (S.D.N.Y. Feb. 23, 2000) (quoting SEC v. Hansen, 1984 WL 2413 at *10 (S.D.N.Y. Apr. 6, 1984)). However, "transaction-based compensation" is "one of the hallmarks of being a broker-dealer." SEC v. Kramer, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. Apr. 1, 2011) (quoting Cornhusker Energy Lexington, LLC v. Prospect Street Ventures, 2006 WL 2620985 at *6 (D. Neb. Sept. 12, 2006)).

D. Registration Violations

Respondents violated the registration provision in the sale of real estate investments to investors by receiving transaction-based fees for facilitating the investments. During the time at issue, Gualario & Co. was not registered as a broker or dealer, and Gualario was not associated with a registered broker or dealer. As payment for effecting the transactions in the real estate investments for their clients, Respondents received $31,000 in commissions. Respondents facilitated the sale of securities of several different issuers, and they made valuations and gave investment advice to clients concerning the merits of real estate investments. As such, Respondents engaged in the business of effecting transactions in securities for the account of others in violation of Section 15(a)(1) of the Exchange Act. Their claim that regulators approved their doing this despite not being registered is unfounded and, in any event, is not a defense to the registration violation.

IV. SANCTIONS

The Division requests a cease-and-desist order,[31] disgorgement of $1,225,873.84 plus prejudgment interest, a third-tier civil money penalty, and that Gualario be barred from the securities industry. As discussed below, Respondents will be ordered to cease and desist from violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act, to disgorge $492,249.67 plus prejudgment interest, and to pay a third-tier civil penalty of $390,000, and broker-dealer, investment adviser, and investment company bars will be imposed on Gualario.

[31] The Division is not requesting a cease-and-desist order against future violation of Advisers Act Rule 206(4)-(4) because that rule is no longer in force. The Commission removed it, effective October 12, 2010. Amendments to Form ADV, 75 Fed. Reg. 49234, 49269 (Aug. 12, 2010). The Commission stated that other rule amendments it adopted rendered Rule 206(4)-(4) "largely duplicative." Id. at 49235.

A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, Advisers Act Release No. 2151 (July 25, 2003), 56 S.E.C. 695, 698. Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schield Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46. As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, Advisers Act Release No. 2052 (Aug. 30, 2002), 55 S.E.C. 1133, 1145, aff'd, 340 F.3d 501 (8th Cir. 2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); see also Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

B. Sanctions

1. Cease and Desist

Sections 8A of the Securities Act, 21C(a) of the Exchange Act, and 203(k) of the Advisers Act authorize the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of those Acts or rules thereunder. Whether there is a reasonable likelihood of such violations in the future must be considered. KPMG Peat Marwick LLP, Exchange Act Release No. 43862 (Jan. 19, 2001), 54 S.E.C. 1135, 1185. Such a showing is "significantly less than that required for an injunction." Id. at 1183-91. In determining whether a cease-and-desist order is appropriate, the Commission considers the Steadman factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. See id. at 1192; see also WHX Corp. v. SEC, 362 F.3d 854, 859-61 (D.C. Cir. 2004).

Respondents' conduct was egregious and recurrent, continuing for more than one year. The conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of the conduct goes beyond a vigorous defense of the charges. Gualario's attempt to displace blame onto Lin and Merlin Securities is an aggravating factor. His chosen occupation in the financial industry will present opportunities for future violations. The violations were neither recent nor remote in time, having ended about four years ago. The degree of harm to the marketplace is quantified in the approximately $8 million in proven losses to investors that resulted from Respondents' misconduct. In light of these considerations, a cease-and-desist order is appropriate.

2. Disgorgement

Sections 8A(e) of the Securities Act, 21C(e) of the Exchange Act, and 203(j) of the Advisers Act authorize disgorgement of ill-gotten gains from Respondents. Disgorgement is an equitable remedy that requires a violator to give up wrongfully-obtained profits causally related to the proven wrongdoing. See SEC v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); see also Hateley v. SEC, 8 F.3d 653, 655-56 (9th Cir. 1993). It returns the violator to where he would have been absent the violative activity.

The Division requests that Respondents be ordered to disgorge ill-gotten gains, including what the Division calculates as $1,070,000 received from the sale of notes that has not been repaid, $10,249.67 in advisory fees earned after Respondents radically changed, but failed to disclose, the Fund's investment strategy, and what the Division calculates as $145,624.17 in real estate fees.

Respondents will be ordered to disgorge $492,249.67, which includes: $31,000 in transaction-based fees for real estate investments from January 2006 through October 2007;[32] $10,249.67 in management fees for the Fund during October 2007, when Gualario engaged in transactions that were materially different from the strategy disclosed to investors; and $451,000, representing the $990,000 in unpaid principal owed on the promissory notes less the $539,000 actually spent to launch the Fund. To the extent that Gualario adverts to taking distributions in lieu of salary, the Commission has the authority to order disgorgement of salary, and by extension, other forms of compensation. See Rita J. McConville, Exchange Act Release No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3151 n.64, petition for review denied, 465 F.3d 780 (7th Cir. 2006); Gregory O. Trautman, Securities Act Release No. 9088 (Dec. 15, 2009), 97 SEC Docket 23492, 23529-32.

While as of the date of the hearing, Respondents had not repaid customers, Gualario has stated that he intends, or wishes, to repay customers for their losses that Respondents caused. Accordingly, disgorgement amounts will be reduced by any amounts that Respondents have paid the customers with respect to the conduct at issue here. See Laurie Jones Canady, Exchange Act Release No. 41250 (Apr. 5, 1999), 54 S.E.C. 65, 84, recon. denied, 54 S.E.C. 255 (1999), petition for review denied, 230 F.3d 362 (D.C. Cir. 2000). To this end, Respondents may submit an accounting showing any amounts they paid to customers with respect to the conduct at issue.

[32] The record evidence includes such fees for additional months beyond those specified in the OIP, January 2006 through October 2007. However, the Commission has not delegated its authority to administrative law judges to expand the scope of matters set down for hearing beyond the framework of the original OIP. See 17 C.F.R. § 201.200(d); J. Stephen Stout, 52 S.E.C. 1162 n.2 (1996). Accordingly, the disgorgement order will not include amounts received in the additional months.

Respondents will be held jointly and severally liable for the disgorgement because Gualario & Co. was Gualario's alter ego in the violative activities. See Daniel R. Lehl, Securities Act Release No. 8102 (May 17, 2002), 55 S.E.C. 843, 874-75 & n.65 (citing SEC v. First Pac. Bancorp, 142 F.3d 1186, 1191 (9th Cir. 1998) (citing SEC v. Hughes Capital Corp., 124 F.3d 449, 455 (3d. Cir. 1997); SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2d. Cir. 1996); Hateley, 8 F.3d at 656)).

3. Civil Money Penalty

Sections 21B of the Exchange Act and 203(i) of the Advisers Act authorize the Commission to impose civil money penalties for willful violations of the Securities, Exchange, Advisers, or Investment Company Acts or rules thereunder. In considering whether a penalty is in the public interest, the Commission may consider six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. See Sections 21B(c) of the Exchange Act and 203(i)(3) of the Advisers Act; New Allied Dev. Corp., Exchange Act Release No. 37990 (Nov. 26, 1996), 52 S.E.C. 1119, 1130 n.33; First Sec. Transfer Sys., Inc., 52 S.E.C. 392, 395-96 (1995); see also Jay Houston Meadows, Exchange Act Release No. 37156 (May 1, 1996), 52 S.E.C. at 787-88, aff'd, 119 F.3d 1219 (5th Cir. 1997); Consol. Inv. Servs., Inc., 52 S.E.C. 582, 590-91 (1996).

As to Respondents, there are no mitigating factors, and there are several aggravating factors. They violated the antifraud provisions, so their violative actions "involved fraud [and] reckless disregard of a regulatory requirement" within the meaning of Sections 21B(c)(1) of the Exchange Act and 203(i)(2) of the Advisers Act. Harm to others is quantified in the approximately $8 million in losses caused to a handful of clients. One client, Wilson, even had to sell her house, move to a rundown apartment, and ask her relatives for money. Deterrence requires substantial penalties against Respondents because of the abuse of the fiduciary duty owed to advisory clients.

Penalties are in the public interest in this case. Penalties in addition to the other sanctions ordered are necessary for the purpose of deterrence. See Sections 21B(c)(5) of the Exchange Act and 203(i)(3)(E) of the Advisers Act; see also H.R. Rep. No. 101-616 (1990). The Division requests that Respondents be ordered to pay third-tier penalties, without specifying dollar amounts or units of violation. In addition to arguing that there were no violations, Respondents argue that civil penalties are not warranted, much less third-tier penalties. Third-tier penalties, as the Division requests, are appropriate because Respondents' violative acts involved fraud and resulted in substantial losses to other persons. See Sections 21B(b)(3) of the Exchange Act and 203(i)(2)(C) of the Advisers Act. Under those provisions, for each violative act or omission after February 14, 2005, the maximum third-tier penalty is $130,000 for a natural person and $600,000 for any other person. 17 C.F.R. §§ 201.1003. The provisions, like most civil penalty statutes, leave the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979).

The events at issue will be considered as three courses of action – the violations arising from the sale of the "Mortgage Bankers" note to Wilson, from the sale of the Gualario & Co. notes, and from the operation of the Fund – resulting in three units of violation. Since Gualario & Co. was essentially a one-man operation and was Gualario's alter ego in the violative activities, a total third-tier penalty amount of $390,000 will be ordered against Respondents, jointly and severally.

4. Bar

The Division requests an "industry bar." Broker-dealer, investment adviser, and investment company bars are authorized pursuant to Sections 15(b) of the Exchange Act, 203(f) of the Advisers Act, and 9(b) of the Investment Company Act[33] and will be ordered.[34] Combined with other sanctions ordered, bars are in the public interest and appropriate deterrents. The violations involved scienter. Respondents' business provides them with the opportunity to commit violations of the securities laws in the future. The record shows a lack of recognition of the wrongful nature of the violative conduct. Gualario's attempt to deflect blame for his actions onto Lin and Merlin Securities is an aggravating factor. Respondents' abuse of the trust placed in them by Wilson is particularly reprehensible.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on January 30, 2012, as corrected on February 10 and 13, 2012.[35]

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[33] The fact that the hedge fund was not a registered investment company is not a barrier to imposing an investment company bar. See Zion Capital Mgmt. LLC, Securities Act Release No. 8345 (Dec. 11, 2003), 57 S.E.C. 99,110 n.27; see also Vladislav Steven Zubkis, Exchange Act Release No. 52876 (Dec. 2, 2005), 86 SEC Docket 2618, 2627, recon. denied, Exchange Act Release No. 53651 (Apr. 13, 2006), 87 SEC Docket 2584 (unregistered associated person of an unregistered broker-dealer barred from association with a broker or dealer).

[34] The Division's request also includes a collateral bar pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). However, Gualario's misconduct antedates the July 22, 2010, effective date of the Dodd-Frank Act. Neither the Commission nor the courts have approved such retroactive application of its provisions in any litigated case, and the undersigned declines to impose the new sanction retroactively. See Koch v. SEC, 177 F.3d 784 (9th Cir. 1999); see also Sacks v. SEC, 648 F.3d 945 (9th Cir. 2011).

[35] See Gualario & Co., LLC, Admin. Proc. No. 3-14340 (A.L.J. Feb. 10, 2012) (unpublished) (revising the description of a May 26, 2011, email from Gualario and adding two entries: a May 27, 2011, email to the parties and the Division's July 25, 2011, Request for Subpoenas); (A.L.J. Feb. 13, 2012) (unpublished) (adding six entries: a May 19, 2011, letter from the Division to Gualario; a May 26, 2011, letter from Gualario to the Division; an August 31, 2011, email and letter from the Division to Gualario; two September 14, 2011, emails from Gualario requesting postponements; and a September 14, 2011, from the Division regarding the requests.

VI. ORDER

IT IS ORDERED that, pursuant to Sections 8A of the Securities Act, 21C(a) of the Exchange Act, and 203(k) of the Advisers Act, Gualario & Co., LLC, and Ronald Gualario CEASE AND DESIST from committing or causing any violations or future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act.

IT IS FURTHER ORDERED that, pursuant to Sections 8A(e) of the Securities Act, 21C(e) of the Exchange Act and 203(j) of the Advisers Act, Gualario & Co., LLC, and Ronald Gualario, jointly and severally, DISGORGE $492,249.67 plus prejudgment interest at the rate established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), compounded quarterly, pursuant to 17 C.F.R. § 201.600(b). Pursuant to 17 C.F.R. § 201.600(a), prejudgment interest is due from November 1, 2007, through the last day of the month preceding which payment is made.

To the extent that Respondents can establish, through an accounting, that they have repaid customers amounts relating to the conduct that is the subject of this proceeding, the disgorgement amount will be reduced by these amounts. If Respondents do not provide an accounting within thirty days of the date of this Initial Decision, the disgorgement amount will remain fixed at that specified above. In the event that Respondents choose to submit an accounting, it shall be filed with the Commission's Secretary, with a copy to the Office of Administrative Law Judges, 100 F St., N.E., Washington, DC 20549-2557.

IT IS FURTHER ORDERED that, pursuant to Sections 21B of the Exchange Act and 203(i) of the Advisers Act, Gualario & Co., LLC, and Ronald Gualario, jointly and severally, PAY A CIVIL MONEY PENALTY of $390,000.

IT IS FURTHER ORDERED that, pursuant to Sections 15(b) of the Exchange Act, 203(f) of the Advisers Act, and 9(b) of the Investment Company Act, Ronald Gualario is barred from association with any broker, dealer, or investment adviser and is prohibited, permanently, 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.

Payment of penalties and disgorgement plus prejudgment interest shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying Respondents and Administrative Proceeding No. 3-14340, shall be delivered to: Office of Financial Management, Accounts Receivable, 100 F Street N.E., Washington, DC 20549-6042. 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(h) of the Commission's Rules of Practice, 17 C.F.R. § 201.111(h). 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.

Carol Fox Foelak
Administrative Law Judge