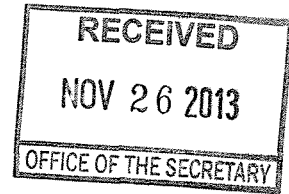


UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15263



In the Matter of

ZPR INVESTMENT MANAGEMENT,
INC. AND MAX E. ZAVANELLI,

Respondents.

DIVISION OF ENFORCEMENT'S POST-HEARING BRIEF

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I. INTRODUCTION

This matter concerns the false and misleading statements in magazines and other publications of ZPR Investment Management, Inc. (“ZPR”), a registered investment adviser, and its president, Max E. Zavanelli, a Commission recidivist. From no later than mid-2008 through the final hearing in this matter, the Respondents have engaged in a series of lies. They lied to and misled potential investors in advertisements about ZPR’s performance returns, the Securities and Exchange Commission’s investigation of ZPR, and ZPR’s compliance with ethical standards known as the Global Investment Performance Standards (“GIPS”). They lied to their own GIPS verifier to conceal their false and misleading advertisements so they could obtain GIPS compliance verification and use it to lure potential investors. They lied to the Commission examination staff, withheld responsive documents, and obstructed the examination. And then they lied to the Commission investigative staff and obstructed that process as well.

This case concerns eleven advertisements. At the final hearing, Zavanelli admitted each of the eleven advertisements at issue in this case contained a false claim of GIPS compliance. However, he claimed it was all just a series of mistakes. The evidence showed otherwise. It demonstrated ZPR and Zavanelli engaged in at least eleven violations of the Investment Advisers Act of 1940 (“Advisers Act”), and Zavanelli, who ran every aspect of ZPR, acted with the highest level of scienter and is responsible with ZPR for each and every one of them.

After ZPR experienced financial losses in the first quarter of 2008, it began falsely advertising GIPS compliance to lure institutional investors while omitting from the advertisements the very information GIPS required – recent and period-to-date performance returns. These returns would have revealed ZPR was trading for negative losses, and so ZPR, at Zavanelli’s direction,

simply omitted them from the firm's October, November, and December 2008 magazine advertisements. ZPR's advertising violations continued in April and December 2009, when Zavanelli distributed newsletters touting the firm's GIPS compliance despite knowing these representations were false and the newsletters omitted the performance returns GIPS requires. ZPR, at Zavanelli's direction, repeated the false statements again in February, March, and May 2011, when the firm again ran false magazine advertisements claiming GIPS compliance.

The Respondents' violations continued even after they learned of the Commission's investigation against them in August 2010. In October 2010 and April 2011, ZPR generated Morningstar, Inc. reports falsely stating there was no Commission investigation against ZPR. Despite knowing these reports were patently false, ZPR and Zavanelli used them to solicit new investors.

Additionally, the Law Judge should infer an adverse inference against Zavanelli and ZPR based on their intentional withholding of responsive documents and their obstruction of the Commission's examination and investigation in this case. Not only did ZPR fail to produce any documents from its so-called "portal," which is ZPR and Zavanelli's primary electronic communications account, but ZPR represented to the Commission that a portal existed but it did not include any ZPR books and records. This was patently false and designed to mislead and obstruct the Commission's examination. The evidence showed the portal did include ZPR's books and records. Further, during the investigation, Zavanelli directed ZPR employees to use only the portal and stated this was to keep the firm's communications away from "the prying eyes of the Commission monster." During the investigation Zavanelli also directed and caused the destruction of account documents from ZPR's computers and the destruction of portal messages. Zavanelli

obstructed the Commission until the eve of the final hearing, when Bauchle told the Division trial counsel the truth about the portal. By that time it was too late because ZPR had lost all portal communications prior to March 2011.

Zavanelli also lied under oath and concealed the portal during the Division's investigation. When asked under oath during his investigative testimony what email he used, he initially stated an address which we learned *during the hearing* was the portal. Zavanelli quickly realized he had exposed the portal address during his investigative testimony and changed his testimony to provide what he claimed was his correct email account. At the final hearing, he admitted under oath that the purportedly correct email account address he provided during the testimony never even existed.

At the final hearing ZPR claimed the documents on the portal for the relevant time period are no longer available. Therefore, the full extent of Zavanelli's orchestration of the violative conduct is unknown. Based on the evidence of the Respondents' obstruction of the examination and investigation and the evidence supporting the Division's claims, the Law Judge should find an adverse inference against the Respondents.

As set forth more fully below, the Division of Enforcement has demonstrated ZPR and Zavanelli violated Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act or, in the alternative as to Zavanelli, that he aided, abetted and caused ZPR's violations of these provisions of the Advisers Act.

The evidence demonstrates the Respondents have no respect for the law, no respect for ethical standards, and no respect for the truth. The Commission seeks the permanent bar of Zavanelli, the censure of ZPR, cease-and-desist Orders against ZPR and Zavanelli, a one-time,

second-tier penalty against ZPR, and second-tier penalties against Zavanelli for each violation at issue in this case.

II. BACKGROUND

A. Respondents

1. ZPR Investment Management, Inc. is a registered investment advisor.¹ Zavanelli originally registered ZPR as an investment advisor in 1994. In June 2001, the firm's assets under management fell below \$25 million and it filed a Form ADV-W to deregister.² ZPR registered in 2006 and remains a registered investment advisor.³ ZPR provides discretionary investment advisory services to approximately 105 clients, with assets under management valued at approximately \$164 million.⁴

2. Max Zavanelli, age 66, resides in Deland, Florida. Zavanelli formed ZPR in 1994 and was its president, chief operating officer, and sole owner, treasurer, board member, and portfolio manager of ZPR until November 2011.⁵ From ZPR's formation until at least April 2013, Zavanelli made all day-to-day decisions concerning ZPR.⁶ He was ZPR's compliance officer from approximately July 2010 until at least July 2011.⁷ In late 2011, during the Commission's investigation of this matter, Zavanelli appointed his son, Mark Zavanelli, as ZPR's president and chief operating officer, and continued in his role as board member, treasurer, and owner. At the

¹ Tr. 143:20-22.

² DX 1 at ¶ B.1, DX 2 at ¶ II.B.1.

³ DX 1; DX 2.

⁴ DX 1 at ¶ C.1; DX 2 at ¶ II.C.1

⁵ Tr 761:8-10; DX 1 at ¶ B.2; DX 2 at ¶ II.B.2; DX 89 at 21:9-12.

⁶ Tr. 145:15-18.

⁷ DX 89 at 23:1-8.

same time, Zavanelli gave Mark Zavanelli a 25% ownership interest in the firm and retained 75% of the ownership.⁸ In October 2013, during the final hearing in these proceedings, Zavanelli gave Mark Zavanelli the remainder of his ownership interest in ZPR⁹. However, Zavanelli admits he continues to direct Mark Zavanelli and all trading activity for the firm.¹⁰

B. Related Individuals and Witnesses

1. **Mark Zavanelli** is Zavanelli's son. He joined ZPR as president in October 2011¹¹ and reported to Zavanelli until at least April 2013.¹² He has an economics degree from the University of Pennsylvania school of business, the Wharton School of Business.¹³

2. **Theodore A. Bauchle** worked at ZPR from September 1995 until April 13, 2013, when Max Zavanelli terminated him the week after the Commission instituted these proceedings, in part because Zavanelli did not approve of Bauchle's investigative testimony in this matter.¹⁴ In 1995, Bauchle was a research assistant for ZPR Investment Research, a company Zavanelli owned.¹⁵ He then worked for ZPR as an investment analyst for about two years commencing in September 1995,¹⁶ and placed trades for ZPR at Zavanelli's direction until 1999.¹⁷ Bauchle was the operations manager at ZPR from about 1999 until April 13, 2013, and was vice president of

⁸ Tr 761:12-17

⁹ Tr. 761:18-23; DX 100

¹⁰ Tr 761:2-7; 758:14-23; DX 98.

¹¹ Tr 1298:11-14.

¹² Tr. 148:10-17.

¹³ Tr. 1306:5-15, 1738:25-1739:5

¹⁴ Tr. 139:21-141:2; 142:22-143:2; 413:3-415:4; DX 102.

¹⁵ Tr. 142:5-21.

¹⁶ Tr. 142:22-143:15.

¹⁷ Tr. 143:13-144:17.

ZPR from 2012 until he was terminated.¹⁸ As operations manager, Bauchle did the trading for the firm at Zavanelli's direction and worked on investment analysis and account reconciliation.¹⁹

3. **Ruth Ann Fay** is Zavanelli's ex-wife and a ZPR employee.²⁰ She was ZPR's compliance officer from approximately 1995 until approximately July 2010.²¹

4. **Nikola Feliz** is a senior manager at Ashland Partners, ZPR's GIPS verification firm, who provided GIPS compliance work for ZPR from 2006 until June 2010. She has worked at Ashland since 2002.²² During her eleven years at Ashland, she has worked as a GIPS compliance verifier and senior manager focusing on GIPS compliance verification.²³ Feliz has a bachelor's degree in accounting and business administration, and has been a Certified Public Accountant since 2005.²⁴ In 2008 or 2009, she received a Certificate in Investment Performance Measurement ("CIPM") from the CFA Institute,²⁵ which sponsors GIPS and oversees the GIPS standards.²⁶ A CIPM concerns GIPS, ethics, and performance measurement, and Feliz received her CIPM after taking two exams and meeting an experience requirement.²⁷

¹⁸ Tr. 144:1-145:7.

¹⁹ Tr. 144:18-24.

²⁰ Tr. 746:2-5

²¹ DX 89 at 23:7-25.

²² Tr. 908:12-17.

²³ Tr. 908:11-910:25.

²⁴ Tr. 906:23-907:13 .

²⁵ Tr. 906:23-907:16.

²⁶ Tr 442:9-20.

²⁷ Tr. 907:17-908:11.

5. **Jean Cabot** was the lead examiner in the Commission's 2009 examination of ZPR.²⁸ She is an examinations manager at the Commission, where she has worked for the past ten years as an examiner or examinations manager.²⁹ She has a bachelor of science degree in business administration and a master's degree in business administration.³⁰ Cabot has experience in GIPS compliance matters, both through her work as an examiner at the Commission and through her prior work experience at Franklin Templeton, where she spent eight years working to ensure global compliance with GIPS.³¹ She has also completed level 1 of the CFA Institute's GIPS program, which included passing the CFA Institute examination concerning GIPS, among other matters.³² Cabot is also a certified fraud examiner.³³

6. **David Sappir** is the sole owner of ZPR Client Management, a company formed in approximately 2007 to communicate with ZPR's clients and potential clients.³⁴ ZPR Client Management is an independent solicitor of clients that provides information to potential clients concerning ZPR, which is Sappir's sole client.³⁵ Sappir is paid thirty percent of all accounts that join ZPR through him.³⁶

²⁸ 443:22-444:3.

²⁹ Tr 439:13-440:25.

³⁰ Tr 439 at 16-22.

³¹ Tr 441:20-442:8

³² Tr 442:15-443:5.

³³ Tr 443:6-8.

³⁴ DX 89 at 26:5-27:23; Tr. 1131:2-9.

³⁵ Tr. 1133:18-1135:63; DX 121.

³⁶ Tr. 1135:14-1136:15.

C. Zavanelli's Regulatory History

Zavanelli is a recidivist with a regulatory history both in the United States and overseas.³⁷ In August 1987, the Commission instituted administrative proceedings against Zavanelli, individually, and doing business as Zavanelli Portfolio Research, for violations of Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act for making material misrepresentations and omissions concerning the firm's investment results from 1979 through 1985.³⁸ Specifically, the Commission alleged Zavanelli reported fictitious results and distributed false advertisements to clients and prospective clients.³⁹ Without admitting or denying the Commission's allegations, Zavanelli settled to, among other things, a censure and a prohibition from soliciting or accepting new advisory clients for a period of 180 days.⁴⁰

Additionally, the equivalent of the Commission in Lithuania brought an action alleging Zavanelli's investment management company in Lithuania violated the Lithuanian securities laws by illegally purchasing United States securities through a foreign broker, and imposed a \$10,000 penalty against Zavanelli's company in 2010.⁴¹

D. ZPR's Formation and Operations

Zavanelli Portfolio Research, Zavanelli's co-Respondent in the first Commission action, is ZPR's predecessor company.⁴² In 1994, Zavanelli, converted Zavanelli Portfolio Research into

³⁷ DX 12, DX 97

³⁸ DX 12; DX 1 at ¶B.2; DX 2 at ¶B.2.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ DX 97, Tr.749:17-751:1.

⁴² Tr. 752:11-14; DX 89 at 12:12-13:3.

ZPR, which is a registered investment adviser.⁴³ As of December 2012, approximately half of ZPR's clients were institutional investors.⁴⁴ The firm allocates clients' assets in equities among several strategies, including the Fundamental Small Cap Value composite ("Small Cap Composite"), a proprietary investment strategy.⁴⁵

Zavanelli made all day-to-day decisions concerning ZPR's operations until at least April 13, 2013.⁴⁶ As Bauchle testified, "He was the boss man. He made all the decisions."⁴⁷ Zavanelli made all decisions on whether ZPR was complying with GIPS so it could represent the firm was GIPS-compliant.⁴⁸ He was aware of the GIPS advertising rules at all times relevant to the conduct at issue because he read GIPS and considered himself the closest thing to an expert there was at ZPR.⁴⁹ He understood that claiming GIPS compliance meant ZPR met all the GIPS standards.⁵⁰ He also approved all advertisements.⁵¹ He was responsible for ensuring that all of ZPR's marketing materials were GIPS-compliant.⁵² Zavanelli, who alternates between residing in Florida and Lithuania, operated ZPR through an electronic portal,⁵³ which is discussed in more detail in

⁴³ *Id.*; Tr. 753:4-8.

⁴⁴ DX 1 at ¶B.1; DX 2 at ¶B.2.

⁴⁵ DX 89:73:10-75:13.

⁴⁶ Tr. 145:15-18.

⁴⁷ Tr. 429:19-25

⁴⁸ Tr. 186:24-187:16.

⁴⁹ DX 89 at 42:9-22

⁵⁰ DX 89 at 45:6-21.

⁵¹ Tr. 186:24-187:16; DX 89 at 57:9-14.

⁵² DX 89 at 46:18-47:2.

⁵³ Tr. 786:3-5

Section IX.C below.⁵⁴ While Mark Zavanelli assumed the title of president in late 2011, Zavanelli has continued making ZPR's trading decisions and directing Mark Zavanelli and the business decisions.⁵⁵

III. IN 2007, ZPR BEGINS CLAIMING GIPS COMPLIANCE TO LURE INSTITUTIONAL INVESTORS

A. GIPS and Its Importance to Institutional Investors

GIPS is an ethical set of standards for investment performance presentation to ensure fair representation and full disclosures of a firm's performance.⁵⁶ GIPS provides comparability between managers globally and provides investors with a level of confidence that the presentations they are viewing are fairly presented.⁵⁷ GIPS compliance is voluntary, but once a firm elects to claim compliance, it has an obligation to follow the GIPS rules and requirements.⁵⁸ This includes an obligation to follow the GIPS advertising guidelines, which set forth information firms must include in their advertisements concerning performance returns.⁵⁹ Investment adviser firms claim GIPS verification because it is currently the best practice in the industry, and it provides a marketing advantage because it provides potential investors with confidence about the performance returns the firm is presenting.⁶⁰ Zavanelli admitted GIPS compliance is very important to institutional clients.⁶¹

⁵⁴ Tr. 146:4-10

⁵⁵ Tr. 758:14-23; 761:2-7; DX 98

⁵⁶ DX 25 at p2 ¶10.b; Tr 903:10-19; 904:9-17.

⁵⁷ DX 25 at p.1, Section C. ("Objectives").

⁵⁸ Tr. 903:10-19; 904:9-17; DX 25 at p.2 ¶10(f).

⁵⁹ DX 25 at p.34.

⁶⁰ *Id.* at 903:20-904:1.

⁶¹ Tr. 827:23-828:1.

GIPS compliance has become almost mandatory for firms looking to delve into the institutional side of business. When institutional clients search for a firm to invest with, they generally ask first whether the firm is GIPS-compliant and then whether the firm is verified as GIPS-compliant.⁶²

B. ZPR Began Claiming GIPS Compliance to Lure Institutional Investors

ZPR decided to claim GIPS compliance because it wanted to attract institutional investors. Zavanelli and Bauchle understood that when institutions are looking for an advisor to manage their money, one of the screens they use is to check whether the investment adviser firm is GIPS-compliant and, if they are not GIPS-compliant, the institutional investors do not consider them.⁶³

In late 2005, ZPR began speaking with an institutional consultant called Greg Reed and Associates that helps institutions find investment advisers to manage their money.⁶⁴ Greg Reed recommended to ZPR that it would be beneficial if the firm obtained GIPS verification and was able to produce performance numbers that adhered to the GIPS policies and procedures.⁶⁵ ZPR understood from Greg Reed that if it claimed GIPS compliance for a period of years, it would be able to effectively compete for institutional clients.⁶⁶

Therefore, in 2006, ZPR retained Ashland Partners, a company that verifies investment adviser firms are complying with GIPS,⁶⁷ and began claiming GIPS compliance in 2007.⁶⁸

⁶² *Id.*

⁶³ Tr.185:12-186:2.

⁶⁴ Tr. 184:10-185:11.

⁶⁵ Tr. 184:10-22.

⁶⁶ Tr. 185:12-16.

⁶⁷ TR 186:3-10, 902:2-14. 906:17-19.

⁶⁸ Tr. 621:15-17.

C. Ashland's Verification of ZPR's GIPS Compliance

1. Beginning in 2006, Ashland Educated ZPR About the GIPS Advertising Guidelines

On January 19, 2006, Ashland sent ZPR a letter explaining that “to claim [GIPS] compliance firms must first meet all the requirements as set forth in the Standards.”⁶⁹ In approximately March 2006, Ashland first educated ZPR about the GIPS advertising guidelines.⁷⁰ The GIPS advertising guidelines are mandatory for firms claiming GIPS compliance.⁷¹ The guidelines dictate what information firms must disclose about performance returns, the method of disclosure, and required disclosures to potential investors in advertisements.⁷² The 2005 GIPS advertising guidelines were in effect through December 31, 2010 and provided as follows:⁷³

All advertisements that include a claim of compliance with the GIPS Advertising Guidelines MUST include the following:

1. A description of the FIRM.
2. How an interested party can obtain a presentation that complies with the REQUIREMENTS of GIPS standards and/or a list and description of all FIRM COMPOSITES.
3. The GIPS Advertising Guidelines compliance statement:

[Insert name of firm] claims compliance with the Global Investment Performance Standards (GIPS).

All advertisements that include a claim of compliance with the GIPS Advertising Guidelines and that present performance results MUST also include the following information (the relevant information MUST be taken/derived from a presentation that adheres to the REQUIREMENTS of the GIPS standards):

⁶⁹ DX 37.

⁷⁰ Tr. 954:20-956:4.

⁷¹ Tr 926:4-15.

⁷² DX 25 at p.34

⁷³ DX 25; Tr. 925:2-10.

4. A description of the strategy of the COMPOSITE being advertised.
5. Period-to-date COMPOSITE performance results in addition to either:
 - a. 1-, 3-, and 5-year cumulative annualized COMPOSITE returns with the end-of-period date clearly identified (or annualized period since COMPOSITE inception if inception is greater than 1 and less than 5 years). Periods of less than 1 year are not permitted to be annualized. The annualized returns MUST be calculated through the same period of time as presented in the corresponding compliant presentation;
 - b. 5 years of annual COMPOSITE returns with the end-of-period date clearly identified (or since COMPOSITE inception if inception is less than 5 years). The annual returns MUST be calculated through the same period of time as presented in the corresponding compliant presentation.
6. Whether performance is shown gross and/or net of INVESTMENT MANAGEMENT FEES.
7. The BENCHMARK TOTAL RETURNS for the same periods for which the COMPOSITE return is presented and a description of that BENCHMARK. (The appropriate COMPOSITE BENCHMARK return is the same BENCHMARK TOTAL RETURN as presented in the corresponding GIPS-compliant presentation.) If no BENCHMARK is presented, the advertisement MUST disclose why no BENCHMARK is presented.
8. The currency used to express returns.
9. The description of the use and extent of leverage and derivatives if leverage or derivatives are used as an active part of the investment strategy (i.e., not merely for efficient PORTFOLIO management) of the COMPOSITE. Where leverage/derivatives do not have a material effect on the returns, no disclosure is REQUIRED.
10. When presenting noncompliant performance information for periods prior to 1 January 2000 in an advertisement, FIRMS MUST disclose the period(s) and which specific information is not compliant as well as provide the reason(s) the information is not in compliance with the GIPS standards.

Ashland educated ZPR about these advertising requirements in at least March 2006,⁷⁴ April 2008,⁷⁵ November 2008,⁷⁶ November 2009,⁷⁷ March 2010,⁷⁸ and mid-2010.⁷⁹ Zavanelli admitted he read the GIPS advertising guidelines in 2005 and considered himself to be the closest thing to an expert there was at ZPR concerning GIPS.⁸⁰ Thus, ZPR and Zavanelli were aware of the GIPS advertising requirements beginning in 2006.

The 2010 GIPS guidelines went into effect on January 1, 2011 and are substantially similar to the 2005 GIPS guidelines, with but included this relevant change to requirement number 5:⁸¹

All advertisements that include a claim of compliance with the GIPS standards by following the GIPS Advertising Guidelines and that present performance **MUST** also disclose the following information, which **MUST** be taken or derived from a **COMPLIANT PRESENTATION**:

5. **COMPOSITE TOTAL RETURNS** according to one of the following:

a. One-, three-, and five-year annualized **COMPOSITE** returns through the most recent period with the period-end date clearly identified. If the **COMPOSITE** has been in existence for less than five years, **FIRMS MUST** also present the annualized returns since the **COMPOSITE INCEPTION DATE**. (For example, if a **COMPOSITE** has been in existence for four years, **FIRMS MUST** present one-, three-, and four-year annualized returns through the most recent period.) Returns for periods of less than one year **MUST NOT** be annualized.

b. Period-to-date **COMPOSITE** returns in addition to one-, three-, and five-year annualized **COMPOSITE** returns through the same period of

⁷⁴ Tr. 954:20-956:4.

⁷⁵ DX 64 at 4.

⁷⁶ DX 47 at 0074.

⁷⁷ DX 84

⁷⁸ DX 51.

⁷⁹ DX 52. (Feliz testimony re when)

⁸⁰ DX 89 at 42:9-22.

⁸¹ DX 26 at p.30; Tr. 925:11-21. While there are other changes to GIPS in 2011, we are only identifying the change relevant to the Division's arguments.

time as presented in the corresponding COMPLIANT PRESENTATION with the period end date clearly identified. If the COMPOSITE has been in existence for less than five years, FIRMS MUST also present the annualized returns since the COMPOSITE INCEPTION DATE (For example, if a COMPOSITE has been in existence for four years, FIRMS MUST present one-, three-, and four-year annualized returns in addition to the period-to-date COMPOSITE return.) Returns for periods of less than one year MUST NOT be annualized.

c. Period-to-date COMPOSITE returns in addition to five years of annual COMPOSITE returns (or for each annual period since the COMPOSITE INCEPTION DATE if the COMPOSITE has been in existence for less than five years) with the period end date clearly identified. The annual returns MUST be calculated through the same period of time as presented in the corresponding COMPLIANT PRESENTATION.

2. Ashland Conducted GIPS Compliance Reviews of ZPR's Advertisements and Other Materials Every Three Months from 2006 until 2010

Ashland conducted a GIPS compliance review of ZPR approximately every three months from 2006 until 2010.⁸² Part of Ashland's quarterly verification work for ZPR included ensuring the development and maintenance of advertisements that complied with GIPS.⁸³ As part of each of these review periods, Ashland requested a series of documents from ZPR that it reviewed for GIPS compliance.⁸⁴ This included all of ZPR's marketing materials.⁸⁵ Prior to Ashland issuing its GIPS verification report for each three-month period, Ashland required that ZPR provide a signed representation letter stating it had provided all of the requested documents.⁸⁶ Ashland relied on this representation from ZPR and without it, Ashland could not verify ZPR as GIPS-compliant.⁸⁷

⁸² Tr. 919:6-19.

⁸³ *Id.* at p.2; DX 38 at p.9 ("Ongoing Quarterly Verification").

⁸⁴ DX 40; Tr. 916:24-917:23.

⁸⁵ DX 40 at page 2, item 5; Tr. 916:24-917:23.

⁸⁶ DX 40; Tr. 921:3-922:6.

⁸⁷ *Id.*

Because GIPS is an ethical set of guidelines, Ashland relied on ZPR to present everything to it correctly because, without complete information from ZPR, the verification would not be valid.⁸⁸

As discussed more fully below, ZPR did not comply with its representations to Ashland. Instead, ZPR withheld its magazine advertisements, which Zavanelli admitted were not GIPS-compliant from Ashland so it could continue to obtain the GIPS compliance verification it needed to attract investors. Zavanelli admitted at the final hearing that *none* of the six magazine advertisements at issue in this case meets the GIPS advertising guidelines.⁸⁹

D. In Mid-2008, Ashland Told ZPR Its Advertisement was not GIPS Compliant and ZPR Therefore Began Concealing its Noncompliant Advertisements from Ashland

In approximately January 2008, ZPR gave Ashland a copy of its January 2008 *Kiplinger* magazine advertisement as part of Ashland's GIPS verification review process.⁹⁰ In mid-2008, Feliz, who worked at Ashland, called Bauchle, ZPR's vice president, advised him the advertisement did not comply with the GIPS advertisement requirements, and explained three things ZPR needed to do to correct the advertisements going forward.⁹¹ First, Feliz told Bauchle that since ZPR was claiming GIPS compliance, ZPR needed to provide: information the GIPS advertising guidelines require, including the currency (*i.e.* dollars or other specific currency of the returns) for the performance returns shown.⁹² Second, Feliz explained ZPR needed to include a disclosure about how an interested investor could receive a GIPS-compliant presentation and list of

⁸⁸ Tr. 922:13-923:7.

⁸⁹ Tr. 1662:6-1686:11; RX 15, 17, 19; DX 5-7.

⁹⁰ DX 55.

⁹¹ Tr. 927:25-929:1

⁹² Tr. 927:25-929:1

composites.⁹³ In the advertisement, ZPR noted how to receive a list and description of the firm's composites, but failed to include the disclosure GIPS required concerning a GIPS-compliant presentation.⁹⁴ A GIPS-compliant presentation shows the basis of GIPS compliance and is a fundamental item a GIPS-compliant firm offers a potential investor.⁹⁵ A GIPS-compliant presentation includes performance returns and assets under management, among other information.⁹⁶ Third, during this same call, Feliz told Bauchle it needed to amend the language in the advertisement representing that Ashland was auditing ZPR's performance returns, because Ashland had not performed an audit.⁹⁷

During that same call or within that same month in mid-2008, Bauchle advised Feliz that ZPR had no intention of advertising further in magazines.⁹⁸ ZPR then proceeded to advertise in magazines for years while withholding the advertisements from Ashland so it could obtain Ashland's seal of GIPS compliance verification to lure investors. Bauchle admitted he only sent Ashland the January 2008 advertisement, and ZPR did not send Ashland the other magazine advertisements the firm published.⁹⁹

⁹³ Tr. 927:25-929:1. According to GIPS, a "composite" is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. DX 25 at 43; 26 at p.37.

⁹⁴ Tr. 929:12-930:2; 932:7-933:7; DX 25 at p.34, item 2; DX 21 at 00002.

⁹⁵ Tr. 933:8-22.

⁹⁶ DX 19 at page 3; Tr. 959:25-961:11.

⁹⁷ *Id.*

⁹⁸ Tr. 933:23-935:2.

⁹⁹ Tr 419:14-21; 420:6-11.

E. From 2008 until 2011, ZPR Continued Knowingly Publishing Advertisements With The Same Defects Ashland Had Identified

After Ashland notified ZPR its advertisement was non-compliant in mid-2008, ZPR continued running advertisements with the same deficiencies Feliz identified¹⁰⁰ to ZPR until at least May 2011. Further, ZPR was aware of the GIPS advertising guidelines when it ran these advertisements because Ashland had provided ZPR with the advertising guidelines checklist that sets forth all of the information GIPS-compliant firms must disclose and Zavanelli admits he read GIPS beginning in 2006.¹⁰¹

ZPR continued to obtain Ashland's GIPS compliance verification by withholding the non-compliant advertisements first from Ashland and then from Ashland's successor firm. Ashland verified ZPR's GIPS compliance every three months until Ashland resigned in July 2010. ZPR then retained a new verifier in November or December 2010 but as of at least July 2011, ZPR was not providing its advertisements to the new verifier either.¹⁰² During this time from mid-2008 until July 2011, ZPR advertised in magazines at least at least 16 times.¹⁰³ After Ashland identified the GIPS deficiencies, ZPR ran advertisements with these same deficiencies in the following magazines as follows:

¹⁰⁰ Tr. 935:3-948:9-15; 967:15-975:1

¹⁰¹ Tr. 948:23-950:16; Tr. 954:20-956; DX 64 at 4.. DX 47 at 0074; DX 84; DX 51; DX 52; DX 89 at 42:9-22.

¹⁰² DX 89 at 161:21-23

¹⁰³ DX 21 at 00003-20; Tr. 935:24-936:11.

Advertisement	Failure to Comply with GIPS Requirement to Identify which Currency is Reflected in the Advertised Returns	Failure to Include the GIPS Disclosure on How to Obtain a Compliant Presentation
October 2008 <i>Smart Money</i> Magazine ¹⁰⁴	x	x
November 2008 <i>Smart Money</i> Magazine ¹⁰⁵	x	x
December 2008 <i>Smart Money</i> Magazine ¹⁰⁶	x	x
November 2009 <i>Smart Money</i> Magazine ¹⁰⁷	x	x
December 2009 <i>Smart Money</i> Magazine ¹⁰⁸	x	x
December 2009 <i>Smart Money</i> Magazine ¹⁰⁹	x	x
January 4, 2010 <i>Baron's</i> Magazine ¹¹⁰	x	x
January 2010 <i>Smart Money</i> Magazine ¹¹¹	x	x
January 11, 2010 <i>Baron's</i> Magazine ¹¹²	x	x
January 18, 2010 <i>Baron's</i> Magazine ¹¹³	x	x
January 25, 2010 <i>Baron's</i> Magazine ¹¹⁴	x	x

¹⁰⁴ DX 21 at 0005. This advertisement included additional GIPS violations, as set forth in Section IV below.

¹⁰⁵ DX 21 at 0006. This advertisement included additional GIPS violations, as set forth in Section IV below.

¹⁰⁶ DX 21 at 0007. This advertisement included additional GIPS violations, as set forth in Section IV below.

¹⁰⁷ DX 21 at 0008.

¹⁰⁸ DX 21 at 0009.

¹⁰⁹ DX 21 at 00010.

¹¹⁰ DX 21 at 00011.

¹¹¹ DX 21 at 00013.

¹¹² DX 21 at 00014.

¹¹³ DX 21 at 00015.

¹¹⁴ DX 21 at 00016.

Advertisement	Failure to Comply with GIPS Requirement to Identify which Currency is Reflected in the Advertised Returns	Failure to Include the GIPS Disclosure on How to Obtain a Compliant Presentation
February 1, 2010 <i>Baron's Magazine</i> ¹¹⁵	x	x
February 8, 2010 <i>Baron's Magazine</i> ¹¹⁶	x	x
February 15, 2010 <i>Baron's Magazine</i> ¹¹⁷	x	x
February 23, 2010 <i>Baron's Magazine</i> ¹¹⁸	x	x
April 2010 <i>Smart Money Magazine</i> ¹¹⁹	x	x
February 2011 <i>Smart Money Magazine</i> ¹²⁰	x	x
March 2011 <i>Smart Money Magazine</i> ¹²¹	x	x
May 2011 <i>Baron's Magazine</i> ¹²²	x	x

In all of these advertisements, ZPR claimed GIPS compliance,¹²³ which required ZPR to follow the GIPS advertising guidelines.¹²⁴ However, ZPR knowingly failed to meet the GIPS advertising guidelines in *any* of the advertisements because they contained the same GIPS

¹¹⁵ DX 21 at 00017.

¹¹⁶ DX 21 at 00018.

¹¹⁷ DX 21 at 00019.

¹¹⁸ DX 21 at 00020.

¹¹⁹ DX 21 at 00021.

¹²⁰ DX 65. This advertisement included additional GIPS violations, as set forth in Section VIII below.

¹²¹ DX 66. This advertisement included additional GIPS violations, as set forth in Section VII below.

¹²² DX 67. This advertisement included additional GIPS violations, as set forth in Section VII below.

¹²³ DX 21 at 00003-21; DX 65-67.

¹²⁴ DX 25, 26.

advertising deficiencies Ashland advised ZPR about in mid-2008.¹²⁵ As Feliz testified, *none* of ZPR's advertised complied with GIPS.

None of the advertisements included the currency notification and disclosure about how to obtain a GIPS-compliant presentation Feliz told ZPR GIPS required.¹²⁶ As set forth in Sections IV and VII below, some of the advertisements included additional GIPS advertising deficiencies because they failed to disclose performance return information GIPS compliance requires. As to ZPR's failure to include the disclosure about how to obtain a GIPS-compliant presentation, Zavanelli subsequently admitted to Feliz he did not want to distribute the presentation because it showed ZPR had a small amount of assets under management.¹²⁷ And so ZPR knowingly omitted this disclosure from its advertisements.

ZPR withheld its non-compliant advertisements from Ashland so it could continue to obtain GIPS compliance verification. ZPR failed to provide *any* advertisement to Ashland during any verification period from mid-2008 until Ashland terminated ZPR in 2010. Instead, Feliz saw the advertisements for the first time when the Division showed them to her during her investigative testimony in 2011.¹²⁸ By keeping the advertisements from Ashland, ZPR was able to obtain Ashland's GIPS compliance verification and tout the verification in its advertisements to lure investors for years.¹²⁹ ZPR now has a new GIPS verifier, and Zavanelli admitted ZPR does not provide its advertisements to the new firm for GIPS-compliance verification.¹³⁰

¹²⁵ Tr. at 936:22-937:25; 947:14-949:1; DX 21 at 00005-21; DX 65-69.

¹²⁶ DX 21 at 00004-21; DX 25 at p.34; Tr. 591:7-614:3.

¹²⁷ Tr. 957:25-959:17.

¹²⁸ Tr. 935:12-16.

¹²⁹ DX 21.

¹³⁰ DX 89 at 96:11-14.

**IV. IN 2008 ZPR AMENDED ITS ADVERTISEMENTS TO
CONCEAL ZPR'S NEGATIVE RETURNS FROM POTENTIAL INVESTORS**

**A. Until Mid-2008, ZPR'S Advertisements Contained The Period-To-Date
Return GIPS Required**

Beginning in late 2006, ZPR advertised each year of performance returns and the period-to-date returns.¹³¹ From 2007 until February 2008, ZPR's period-to-date performance returns outperformed ZPR's index, the Russell 2000.¹³² During this time, ZPR's magazine advertisements, while lacking all the GIPS required information, disclosed the period-to-date performance returns and benchmark returns GIPS requires.¹³³

**B. In 2008, ZPR Amended Its Advertisements To Omit Recent Performance Returns And
Conceal Its Negative Performance**

In 2008, ZPR's business took a turn for the worse, and this affected the return information it disclosed to potential investors. In 2008, ZPR realized income of less than \$7,000.¹³⁴ In March 2008, ZPR suffered its worst performance returns.¹³⁵ Zavanelli admitted advertising the period-to-date returns would have revealed the poor performance.¹³⁶ Therefore ZPR changed the format of its advertisements to exclude this information.¹³⁷ Beginning with its next advertisement, which was in October 2008, ZPR excluded the period-to-date performance returns and the returns for

¹³¹ Tr. 187:17-188:14; DX 89 at 139:8-140:1.

¹³² DX 18.

¹³³ DX 89 at 139:8-140:1.

¹³⁴ DX 79 at paragraph 4

¹³⁵ DX ; Tr.

¹³⁶ DX 89 at 142:6-24.

¹³⁷ Tr. 188:15-189:5.

each year as GIPS requires.¹³⁸ Instead, ZPR advertised only its favorable historic performance returns.¹³⁹ Zavanelli admitted this new version of the advertisements did not comply with GIPS.¹⁴⁰

In September 2008, Bauchle had discussions with Zavanelli and Fay to express his concern that if they changed the advertisement from showing each year's performance returns, they needed to show the 1, 3, and 5 year returns GIPS requires.¹⁴¹ Bauchle and Fay agreed the advertisement was not GIPS-compliant without this information. Bauchle told Zavanelli the advertisement was not GIPS-compliant, but Zavanelli published it anyway in *Smart Money* magazines dated October, November and December 2008.¹⁴² Each of these advertisements failed to include the performance return information GIPS requires.¹⁴³

Instead, ZPR chose to only advertise historic performance returns showing ZPR was outperforming its benchmark index, the Russell 2000.¹⁴⁴ In reality, when ZPR issued these advertisements, it was *underperforming* the Russell 2000. However, ZPR did not disclose this information to potential investors in the advertisements. Had ZPR complied with GIPS, as it claimed, the advertisements would have reflected the negative performance results and underperformance.

¹³⁸ *Id.*; DX 21 at 00005; DX 89 at 139:8-140:1.

¹³⁹ Tr. 188:15-189:18; DX 21 at 0005 (October 2008 Advertisement).

¹⁴⁰ DX 89 at 139:8-140:1.

¹⁴¹ Tr. 193:1-18.

¹⁴² Tr. 487:5-491:15.

¹⁴³ Tr. 204:9-205:10; 487:5-491:15; DX 21 at 00005-0008.

¹⁴⁴ *Id.*; Tr. 485:14-486:1.

1. ZPR's False and Misleading October 2008 Advertisement

In the October 2008 *Smart Money* magazine advertisement, ZPR told potential investors the following:

FINDING AN OPPORTUNITY IN A TOUGH MARKET¹⁴⁵

Performance Thru 6/30/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 10 Yr. Return	277.60%	71.21%	32.87%
Annualized	14.21%	5.52%	2.88%

ZPR and Zavanelli failed to disclose that for its most recent period returns, January 1, 2008 through June 30, 2008, ZPR experienced negative returns.¹⁴⁶ Bauchle admitted ZPR omitted this information from the advertisement because revealing the negative returns would have looked bad to potential investors.¹⁴⁷ In reality, had ZPR disclosed this information to potential investors, it would have revealed that ZPR's performance return for this period was **-17.02%**.¹⁴⁸ This was less than ZPR's benchmark index, the Russell 2000, which had a return of **-9.38%** for the same period.¹⁴⁹ Thus, ZPR's period-to-date returns showed it was underperforming its benchmark index. However, ZPR did not disclose this to investors. Zavanelli approved the advertisement and made the decision to publish it even after Bauchle told him the advertisement lacked the necessary performance return information.¹⁵⁰

¹⁴⁵ DX 21 at 00005.

¹⁴⁶ Tr. 189:12-190:6; DX 89 at 142:6-24.

¹⁴⁷ Tr. 188:15-189:18.

¹⁴⁸ Tr. 479:23-484:16.

¹⁴⁹ Tr. 479:23-484:11.

¹⁵⁰ Tr. 487:5-491:15; DX 155.

2. The November 2008 Advertisement

ZPR repeated this same misleading advertisement in the November 2008 edition of *Smart Money* magazine, when it touted its performance through August 31, 2008 as outperforming its benchmark index, the Russell 2000 index. The advertisement showed the following.

FINDING AN OPPORTUNITY IN A TOUGH MARKET¹⁵¹

Performance Thru 8/31/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 10 Yr. Return	415.14%	148.89%	57.93%
Annualized	17.81%	9.53%	4.68%

But ZPR and Zavanelli omitted to disclose the negative performance returns.¹⁵² Bauchle admitted ZPR omitted this information because the period-to-date returns would have revealed negative performance returns, which would have looked bad to potential investors.¹⁵³ In reality, ZPR's period-to-date performance, from January 1, 2008 through August 31, 2008, was -12.70%.¹⁵⁴ Not only did ZPR fail to disclose its negative performance returns, but also it failed to disclose that it was underperforming its benchmark index, the Russell 2000.¹⁵⁵ The return for the Russell 2000 for this same period was -2.63%.¹⁵⁶ Thus, ZPR's period-to-date returns showed it was underperforming its benchmark index. However, ZPR did not disclose this to investors.

¹⁵¹ DX 21 at 00006.

¹⁵² Tr. 190:7-16; DX 89 at 142:6-24.

¹⁵³ Tr. 188:15-190:16.

¹⁵⁴ Tr. 479:23-485:13.

¹⁵⁵ *Id.*

¹⁵⁶ Tr. 479:23-484:11.

Zavanelli approved the advertisement and made the decision to publish it even after Bauchle told him the advertisement lacked the necessary performance return information.¹⁵⁷

3. ZPR's December 2008 Advertisement

ZPR repeated this same misleading advertisement in the December 2008 edition of *Smart Money* magazine, when it touted its performance through August 31, 2008 as outperforming its benchmark index, the Russell 2000. The advertisement showed the following.

THINK LONG TERM¹⁵⁸

Performance thru 8/31/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 20 yr. return	1187.05%	509.76%	565.18%
Compounded 10 yr. Return	357.82%	111.99%	35.20%
Compounded 5 yr. Return	75.45%	47.92%	28.65%

ZPR and Zavanelli omitted to disclose the negative performance returns, which Zavanelli admitted would have reflected poor performance for 2008.¹⁵⁹ Bauchle admitted ZPR omitted the period-to-date returns in this advertisement because it would have looked bad to potential investors.¹⁶⁰ In reality, ZPR's period-to-date performance, from January 1, 2008 through September 30, 2008, was **-18.42%**.¹⁶¹ Not only did ZPR fail to disclose its negative performance returns, but also it failed to disclose that it was underperforming its benchmark index. The return

¹⁵⁷ Tr. 193:1-18; 487:5-491:15.

¹⁵⁸ DX 21 at 0007.

¹⁵⁹ DX 89 at 142:6-24.

¹⁶⁰ Tr. 188:15-190:22.

¹⁶¹ Tr. 479:23-484:11.

for the Russell 2000 for this same period was -10.39%.¹⁶² Thus, ZPR's period-to-date returns showed it was underperforming its benchmark index. However, ZPR did not disclose this in the advertisement.¹⁶³ Zavanelli approved the advertisement and made the decision to publish it even after Bauchle told him the advertisement lacked the necessary performance return information.¹⁶⁴

C. ZPR Falsely Touted The Firm's GIPS Compliance In These Same Advertisements

In these same advertisements, ZPR also advertised Ashland had verified it as GIPS-compliant.¹⁶⁵ This was misleading for at least two reasons. First, GIPS requires that when a firm claims GIPS compliance, it must follow the GIPS advertising guidelines.¹⁶⁶ Accordingly, ZPR was required to follow the GIPS advertising guidelines in the advertisements. However, as set forth above, it failed to do so because the advertisements lacked: (a) period-to-date performance returns; and (b) five consecutive years of performance returns or 1-, 3, and 5-year performance returns. Second, ZPR knew Ashland's verifications were bogus because, as set forth above, ZPR withheld its non-compliant advertisements from Ashland's verification review. Thus, Ashland's verification of ZPR's GIPS compliance was incomplete and did not include the non-compliant advertisements.

¹⁶² Tr. 479:23-484:11.

¹⁶³ DX 21 at 00008

¹⁶⁴ Tr. 193:1-18; 487:5-491:15; DX 155.

¹⁶⁵ DX 21 at 00005.

¹⁶⁶ DX 25 at p.34.

V. IN FEBRUARY 2009 AND JANUARY 2010, THE SEC ADVISED ZPR THAT ITS ADVERTISEMENTS WERE NOT GIPS COMPLIANT AND WERE MISLEADING

A. The Examination

The Commission examines investment advisors to ensure they comply with the federal securities laws and that their disclosures are accurate and truthful.¹⁶⁷ The examiners review firm documents, books and records, and interview individuals at the investment adviser.¹⁶⁸ When investment advisers represent to investors or potential clients that they are GIPS-compliant in their advertising and marketing materials, the examination includes a review of GIPS compliance representations.¹⁶⁹

In January and February 2009, the Commission examined ZPR's books and records. As part of the examination, the examination staff requested all of ZPR's books and records and reviewed them for GIPS compliance, among other things.¹⁷⁰ The examiners also conducted an on-site exam at ZPR from February 2 until February 13, 2009¹⁷¹, and interviewed Zavanelli, Bauchle, and Fay.¹⁷²

B. The Commission's Deficiency Letter

On February 13, 2009, Cabot, the lead Commission examiner, met with Bauchle and Fay to advise them of deficiencies the Commission found concerning ZPR's advertisements.¹⁷³ Among other things, Cabot told them the December 2008 advertisement failed to comply with the GIPS

¹⁶⁷ Tr 440:6-15.

¹⁶⁸ Tr 440:6-15.

¹⁶⁹ Tr. 440:16-22.

¹⁷⁰ RX 42; DX 77.

¹⁷¹ DX 77.

¹⁷² Tr. 444:11-445:10.

¹⁷³ DX 77; Tr. 431:2-432:5, 486:2-488:20.

requirements to disclose period-to-date and yearly returns.¹⁷⁴ Cabot also indicated the advertisements falsely stated Ashland audited ZPR's returns.¹⁷⁵ Bauchle and Fay told Cabot they knew the advertisements were not GIPS-compliant and had conveyed that to Zavanelli, but Zavanelli made the decision to publish the advertisements anyway.¹⁷⁶

The Commission memorialized these and other findings in a deficiency letter to ZPR dated January 2010.¹⁷⁷

**C. ZPR Told The Commission It Would Cure The Deficiencies By Taking
Certain Corrective Actions And Then Failed To Do So**

In the deficiency letter, the Commission raised a series of regulatory deficiencies concerning ZPR's advertisements and other matters, and asked ZPR to take corrective action.¹⁷⁸ Not only did ZPR promise to take corrective action and then fail to take it, but also ZPR was dishonest in its response to the Commission.¹⁷⁹

1. Failure to Correct Disclosure of Performance Returns Despite Assurances to the Contrary

First, in February 2009 and again in the deficiency letter, the examination staff advised ZPR its December 2008 advertisement was misleading because it stated ZPR was GIPS-compliant but failed to comply with the GIPS advertising guidelines.¹⁸⁰ Specifically, the staff told ZPR the

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ DX 77.

¹⁷⁸ *Id.*

¹⁷⁹ This conduct is not alleged as a violation in the OIP, but it is relevant to determining scienter, as discussed in Section X below.

¹⁸⁰ *Id.* at Section I.B

advertisement lacked the following information GIPS requires: (1) period-to-date returns; and (2) 1, 3, and 5 year annualized composite returns or five years of annualized composite returns.¹⁸¹

In response, ZPR claimed in a February 2010 letter to the Commission that it was unaware it needed to show annualized returns.¹⁸² This was not true. In August or September 2008, Bauchle, Zavanelli, and Fay discussed the GIPS requirements of including annualized returns in the advertisements.¹⁸³ Further, in at least 2006, 2008, and 2009, Ashland had advised ZPR of the GIPS advertising requirements.¹⁸⁴ Thus, ZPR was well aware of the performance return disclosures GIPS required.

Additionally, ZPR assured the Commission it would take the following corrective action: “We have changed our ads to show the 1, 3, 5-year annualized returns in US dollars and will revise our footnotes.”¹⁸⁵ ZPR then continued to advertise it was GIPS-compliant while failing to disclose its 3- and 5-year annualized returns.¹⁸⁶ As set forth more fully below, ZPR failed to disclose this information in several of the advertisements at issue in this case, despite its assurances to disclose it. For example, ZPR failed to disclose this information in the April and December 2009 newsletters discussed in Section VI.B below and in the February, March, and May 2011 magazine advertisements¹⁸⁷ discussed in Section VII below.

¹⁸¹ *Id.*

¹⁸² DX 78 at Section B.

¹⁸³ Tr. 228:1-25.

¹⁸⁴ DX 47 at page 74.

¹⁸⁵ DX 78.

¹⁸⁶ DX 6 at page 2; DX 66 at page 2.

¹⁸⁷ DX DX 8-9, DX 65-67.

2. Failure to Provide Currency and Benchmark Information GIPS Requires Despite Assurances to the Contrary

Second, the Commission advised ZPR its advertisements failed to include a description of the benchmark index ZPR advertised and the currency used to express the returns, as GIPS requires.¹⁸⁸ In response, ZPR advised the Commission it was “puzzled” the Commission advised it to include a description of the benchmark and state the currency of the returns in the advertisements, and claimed to “wonder why Ashland Partners did not mention this during [the] verification process.”¹⁸⁹ This was also false. Ashland had previously advised ZPR about these requirements in at least 2006, 2008, and 2009.¹⁹⁰ In addition, as set forth above, during Ashland’s verification process in approximately mid-2008, Feliz had pointed out the same deficiency concerning the lack of currency in ZPR’s January 2008 *Kiplinger* advertisement. Further, in 2009, Ashland told ZPR at least two times to include this information during the verification process.¹⁹¹ Yet ZPR falsely told the Commission Ashland had never raised this issue.¹⁹²

ZPR assured the Commission it would take corrective action to cure these two deficiencies, and then failed to do so in subsequent advertisements it distributed through 2011.¹⁹³

3. Failure to Cease False Claim of Audit Despite Assurances to the Contrary

Third, the Commission advised ZPR its advertisements falsely claimed Ashland audited ZPR’s performance returns because Ashland had only verified the firm as GIPS-compliant.¹⁹⁴ This

¹⁸⁸ DX 77

¹⁸⁹ DX 78 at Section B.

¹⁹⁰ DX 47 at page 74-75.

¹⁹¹ DX 47

¹⁹² DX 47

¹⁹³ DX 21

was not the first time ZPR was apprised its auditing claim was false. In early 2009, Ashland also raised this issue with ZPR and advised the firm it should stop saying Ashland audited ZPR because this was not accurate.¹⁹⁵ In addition, in October 2009, Ashland notified ZPR in writing that its verification was not an audit.¹⁹⁶

In response to the Commission's deficiency letter, ZPR claimed it would take corrective action by describing Ashland's work as a verification rather than an audit.¹⁹⁷ This also proved false. Just two months later, in April 2010, Zavanelli, on behalf of ZPR, sent a letter to potential investors including a brochure stating ZPR's returns were audited.¹⁹⁸ Five months after that, in September 2010, ZPR provided information to Morningstar stating its results had been "audited for GIPS compliance for the period December 31, 2000 to the present" by Ashland.¹⁹⁹ This was false and contradicted what ZPR told the Commission it would do to take corrective action.

Thus, the evidence demonstrated that even when ZPR claimed it would take corrective action, it failed to do so and knowingly repeated the same improper conduct.

VI. ZPR'S MISLEADING CLIENT NEWSLETTERS

A. The Newsletters Were Advertisements

ZPR and Zavanelli distributed monthly newsletters, also referred to as investment reports, from Zavanelli to the firm's clients, and made these newsletters available through ZPR's

¹⁹⁴ DX 77

¹⁹⁵ Tr 239:6-16

¹⁹⁶ DX 19

¹⁹⁷ DX 78 at p.3

¹⁹⁸ DX 22 at page 2 and 367; Tr. 242:22-244:13, 246:14-19.

¹⁹⁹ DX

website.²⁰⁰ The newsletters qualified as advertisements under GIPS. Since ZPR claimed GIPS compliance in them, ZPR was required to follow the GIPS advertising guidelines.²⁰¹ GIPS defines an advertisement as follows:

any materials that are distributed to or designed for use in newspapers, magazines, firm brochures, letters, media, or any other written or electronic material addressed to more than one prospective client. *Any written materials (other than one-on-one presentations and individual client reporting) distributed to maintain existing clients or solicit new clients for an advisor is considered an advertisement.*²⁰²

Zavanelli distributed the newsletters to clients to maintain them.²⁰³ In the newsletters, Zavanelli explained his trading strategy, market developments, and, when discussing downturns in the market, assured clients he invested using a long-term strategy.²⁰⁴ ZPR also published the newsletters on its website and in its advertisements directed potential clients to the website.²⁰⁵ Thus, the newsletters were clearly advertisements under GIPS, a fact which Mark Zavanelli has admitted as president of ZPR.²⁰⁶

B. The April and December 2009 Newsletters Omitted GIPS-Required Performance Returns That Would Have Revealed ZPR's Negative Performance Returns

Newsletters ZPR and Zavanelli disseminated in 2008 and 2009 claimed ZPR was GIPS-compliant, but failed to include performance returns that complied with GIPS or a GIPS-compliant

²⁰⁰ Zavanelli approved what went on the website and determined whether or not it was GIPS-compliant. DX 89:118;-10-119:11.

²⁰¹ Tr. 956:11-957:5.

²⁰² DX 25 at 33 (“Definition of Advertisement”) (emphasis added).

²⁰³ Tr 846:12-24.

²⁰⁴ DX 44; DX 89 at 127:6-128:8.

²⁰⁵ DX 21

²⁰⁶ DX 133

presentation.²⁰⁷ Feliz told Zavanelli the newsletters were advertisements, and that since he claimed in the newsletters that ZPR was GIPS-compliant, he was required to comply with the GIPS advertising guidelines or include a GIPS-compliant presentation with the newsletter.²⁰⁸ In November 2008, Ashland emailed ZPR with instructions about how to correct the newsletters so they complied with GIPS.²⁰⁹ Specifically, Ashland advised ZPR to either: (1) amend the newsletters to include all of the information the GIPS advertising guidelines require, including 1-, 3-, and 5-year returns or performance returns for each of the most recent five years; or (2) attach a GIPS-compliant presentation.²¹⁰

Bauchle took Ashland's advice on one occasion and attached the GIPS-compliant presentation in late 2008.²¹¹ Bauchle did not consult Zavanelli before attaching the presentation to the newsletter because Bauchle knew Zavanelli would disagree.²¹² Zavanelli did not want potential investors to view the GIPS-compliant presentation because it showed a small number of assets under management.²¹³ When Zavanelli subsequently learned Bauchle had attached the presentation to the newsletter, he got upset because he did not want others to know the small amount of assets under management.²¹⁴ Therefore, at Zavanelli's direction, ZPR never again

²⁰⁷ DX 47

²⁰⁸ Tr. 956:11-957:5. Since ZPR published the newsletter on its website, Feliz advised ZPR it must make its website GIPS-compliant. DX 84; Tr. 201:16-203:14. However, Zavanelli told Feliz he did not want to include the compliant presentation on the website to make it comply with GIPS because this would have revealed the small number of assets ZPR had under management. Tr. 957:6-24.

²⁰⁹ DX 47

²¹⁰ DX 47

²¹¹ DX 47; Tr. 206:18-207:2.

²¹² Tr. 207:3-20

²¹³ *Id.*

²¹⁴ Tr. 207:3-208:15

attached the presentation to the newsletter.²¹⁵ Zavanelli told Feliz he did not want to include the compliant presentation because it showed a small number of assets under management.²¹⁶ Feliz told Zavanelli he needed to amend the newsletter so it complied with the GIPS advertising guidelines by including the information those guidelines require.²¹⁷ ZPR failed to take any corrective action.

Instead, ZPR continued to distribute newsletters to clients and potential clients on its website that omitted the performance returns GIPS requires - even after Ashland advised ZPR the advertisements were not GIPS-compliant in 2008; even after the Commission advised ZPR in February 2009 it had to include the annual performance returns in its advertisements; and even after ZPR assured the Commission it would take corrective action to provide this information.

For example, ZPR's April and December 2009 newsletters claimed compliance with the GIPS standards.²¹⁸ Yet, the performance results included in those newsletters did not include the period-to-date returns and 1-, 3-, and 5-year returns or the most recent five years of performance returns.²¹⁹ As discussed in above in Section IV, ZPR's performance returns for the year 2008 were negative and showed ZPR underperforming the market. Thus, had ZPR disclosed the one-year returns in the 2009 advertisements, as GIPS required, it would have revealed ZPR's negative performance returns and underperformance of the index for the one-year period of 2008. Therefore, ZPR chose to omit this information and only disclose its positive historic returns.

²¹⁵ *Id.*

²¹⁶ Tr. 957:6-24.

²¹⁷ *Id.*

²¹⁸ DX 8, DX 9

²¹⁹ *Id.*

Nor did ZPR attach a GIPS-compliant presentation to these newsletters.²²⁰ Had ZPR attached the GIPS-compliant presentation, it would have shown ZPR had a relatively small amount of assets under management. This was precisely the information Zavanelli wanted to conceal from clients and potential investors.²²¹ Therefore, ZPR chose to omit this information while still claiming GIPS compliance. As a result of ZPR's repeated failure to comply with GIPS in its newsletters, Ashland terminated ZPR as a client in June 2010.²²² Feliz testified that she has worked for 400 or more clients as a GIPS verifier and has terminated one – ZPR.²²³

C. Other Misleading Statements in ZPR's Newsletters

Additionally, several of ZPR's newsletters also made claims about potential profits without disclosing the possibility of losses. For example, one newsletter in November 2008 during the height of the financial crisis, contained statements such as “[m]any of our stocks can be expected to gain 200-400% in the next year” and “[o]ver the next 5 years, we have the horses to easily make 300%.”²²⁴ None of the newsletters contained any risk disclosures to inform the firm's clients and potential clients of the possibility that losses may occur.²²⁵ ZPR did not have a reasonable basis for making these projections because when ZPR made them, the firm was trading for negative returns.²²⁶

²²⁰ Tr. 207:3-20.

²²¹ Tr. 207:3-20

²²² DX 36

²²³ Tr 1006:19-1007:4

²²⁴ DX 71

²²⁵ DX 8, 9, 71.

²²⁶ DX 18

VII. IN 2011, ZPR DISTRIBUTED FALSE AND MISLEADING MAGAZINE ADVERTISEMENTS

In the February and May 2011 issues of *Smart Money* and a March 2011 issue of *Barron's* magazine, ZPR advertised performance returns for its "Global Equity" and "All Asian" composites while claiming compliance with the GIPS standards.²²⁷ As with the 2008 advertisements discussed in Section IV above, these advertisements failed to include certain GIPS required information such as 3 and 5-year annualized returns or 5 years of annual returns, as well as period-to-date returns.²²⁸ Notably, ZPR published these advertisements after assuring the Commission in 2010 that it would take corrective action to disclose its 1-, 3-, and 5-year and period-to-date returns in all advertisements.²²⁹ Rather than disclose this information, which ZPR knew GIPS required, it disclosed the performance returns it wanted to disclose and omitted those GIPS required. Nonetheless, ZPR falsely claimed GIPS compliance in these same advertisements so it could continue to lure potential institutional investors. Zavanelli admitted he approved these advertisements.²³⁰

Zavanelli claimed the advertisements included the GIPS compliance claim while not complying with GIPS because they were reprints.²³¹ However, this excuse also proved to be false. Zavanelli admitted he made *seventeen* changes to the original advertisements before he reprinted them.²³² He admitted that one of the changes he made was to add the statement that ZPR was

²²⁷ DX 65-67.

²²⁸ *Id.*

²²⁹ DX 78

²³⁰ DX 89 at 67:3-10; 69:1-6; 72:16-20; DX 65-67.

²³¹ Tr. 116:10-15; RX 15, 17, 19.

²³² Tr. 1162:6-1664:3.

GIPS-compliant.²³³ And he admitted that of all the changes he made to the advertisements before reprinting them, none of these changes included adding the information the GIPS advertising guidelines require.²³⁴ Thus, Zavanelli simply chose to add the claim of GIPS compliance while ignoring the GIPS advertising rules altogether.

VIII. ZPR'S FALSE STATEMENTS ABOUT THE COMMISSION'S INVESTIGATION AND ZPR'S GIPS VERIFIER

ZPR also advertised in reports published by Morningstar, Inc. These reports were advertisements under GIPS because ZPR used them to solicit clients. Beginning in 2005, ZPR submitted its data to the Morningstar database to help solicit potential investors.²³⁵ The Morningstar database is comprised of investment adviser information and is a tool Morningstar sells to institutional investors to allow them to research potential investment advisors to manage their money.²³⁶ ZPR also advertised its Morningstar rating in its *Smart Money* and *Barron's* magazine advertisements.²³⁷ ZPR also emailed its Morningstar reports to potential clients.²³⁸

In a Morningstar report published in October 2010 and containing ZPR's performance figures for the period ending September 30, 2010, the firm stated that its results had been "audited for GIPS compliance for the period December 31, 2000 to the present" by Ashland.²³⁹ This was a false statement because Ashland had resigned as ZPR's GIPS verification firm in July 2010 and its last report attesting to ZPR's compliance with GIPS, covered the period ending December 31,

²³³ Tr. 1665:1-1668:22.

²³⁴ *Id.*

²³⁵ Tr. 248:25-249:25.

²³⁶ Tr. 249:13-20

²³⁷ DX 21

²³⁸ DX 153, DX 154

²³⁹ DX 10; Tr. 255:21-256:2.

2009.²⁴⁰ In October 2010, ZPR did not even have a GIPS verifier because Ashland resigned effective July 2010 and ZPR did not retain a new verifier until November or December 2010.²⁴¹ Moreover, while ZPR claimed Ashland had audited the firm, ZPR knew this statement was false and misleading. As discussed above, Ashland had raised this issue and directed ZPR to cease from stating it audited the firm in early 2009, and the Commission examination staff did the same in February 2009 and February 2010.²⁴²

In that same Morningstar report, ZPR stated it was not under a “pending Commission investigation.”²⁴³ When ZPR provided this information to Morningstar, he knew it was false. ZPR provided the information for the Morningstar report after September 30, 2010 because the report includes performance returns through that date.²⁴⁴ Bauchle testified it was in approximately October 2010 that the Morningstar report was generated.²⁴⁵ However, Zavanelli admitted he was aware of the Commission’s investigation of ZPR by August 16, 2010.²⁴⁶ On that date, the Commission sent ZPR a letter stating “The staff of the Miami regional office of the Securities and Exchange Commission is conducting an investigation in the above-referenced matter,” and references “ZPR International Management, Inc., FL-3548.”²⁴⁷ Despite knowing the Commission

²⁴⁰ DX 36

²⁴¹ DX 89 at 161:21-23.

²⁴² DX 77

²⁴³ DX 10

²⁴⁴ DX 10

²⁴⁵ Tr. 253:2-254:1; 255:21-256:2

²⁴⁶ 773:13-16

²⁴⁷ DX 92

was conducting an investigation concerning ZPR, the firm nonetheless advertised there was no pending Commission investigation. Zavanelli was aware of the Morningstar reports.²⁴⁸

On October 14, 2010, the Commission took Bauchle's testimony²⁴⁹ and advised him it was in connection with an investigation.²⁵⁰ He understood at that time that the purpose of his testimony was for a Commission investigation about ZPR.²⁵¹ Zavanelli was aware of this testimony in October 2010 and arranged counsel for Bauchle.²⁵² On October 27, 2010, the Commission sent ZPR another letter stating the firm was under investigation.²⁵³ By November 2010, ZPR was represented by counsel in the investigation, and on November 30, 2010, the Commission sent another letter, this time to ZPR's counsel, stating there was an investigation concerning ZPR.²⁵⁴

The Commission took investigative testimony from Zavanelli in June 2011, and Bauchle in October 2010.²⁵⁵ During each testimony, the Commission staff explained that the testimony was being conducted in connection with an investigation of ZPR.²⁵⁶ However, in April 2011, ZPR once again provided information to Morningstar falsely stating it was not under a pending Commission investigation.²⁵⁷

²⁴⁸ DX 157.

²⁴⁹ Tr 773:17-25

²⁵⁰ Tr. 437:24-438:4

²⁵¹ Tr 437:18-438:4.

²⁵² Tr 773:17-774:9

²⁵³ DX 92 at p.5.

²⁵⁴ DX 92 at p.13

²⁵⁵ DX 89 at 6:1; Tr. 437:24-438:4

²⁵⁶ DX 89 at 6:1; Tr. 437:24-438:4

²⁵⁷ DX 11; Tr. 255:3-13

At no time did ZPR seek to correct these Morningstar reports.²⁵⁸ Further, after Mark Zavanelli became president, he directed Bauchle to state in the Morningstar report that there was no pending Commission investigation.²⁵⁹ When Mark Zavanelli directed Bauchle to provide this false information, he knew there was a Commission investigation because he had read the investigative testimony stating there was an investigation and was paying lawyers to defend ZPR in the investigation.²⁶⁰ When confronted with these facts and his failure to take any corrective action after becoming president of ZPR, Mark Zavanelli claimed he did not know there was a Commission investigation.²⁶¹ This denial is belied by the evidence. Mark Zavanelli is an Ivy-league educated businessman with a 15-year career in the securities industry who not only admitted to reading the investigative testimony transcripts stating there was an investigation but also admitted to paying lawyers to defend ZPR in the investigation.²⁶² Accordingly, the Law Judge should find Mark Zavanelli's sworn testimony not credible.²⁶³

IX. LEGAL DISCUSSION

As set forth more fully in Section IX.C below, the Division seeks an adverse inference against ZPR and Zavanelli for their willful failure to produce any documents from their primary electronic communication source, the portal. The Respondents withheld these documents, which were responsive to the Commission's requests for documents during the examination and

²⁵⁸ Tr. 259:9-260:20.

²⁵⁹ DX 132.

²⁶⁰ Tr 1299:2-1310:20; DX 132; Tr. 131:11-1314:8; 1322:1-1323:13; 1325:18-1328:21; DX 89 at 6:1; Tr. 437:24-438:4.

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ Mark Zavanelli also admitted he reviewed the GIPS issues and the deficiency letter of January 2010, but took no corrective action until after the Commission instituted the OIP. 1322:1-1323:13.

investigation, and lied to the Commission to keep these communications concealed. While the portal communications were available when they were requested, Zavanelli claims ZPR lost them in March 2011. Thus, the Respondents' communications during the period when the violations occurred from 2008 until March 2011 are gone. Based on the Zavanelli and ZPR's conduct in connection with willfully concealing these communications from the Commission and obstructing the examination and investigation, the Law Judge should find that had they been produced, they would have been damaging to the Respondents' case.

A. Violations of the Anti-Fraud Provisions of the Advisers Act

ZPR and Zavanelli's distribution and false or misleading advertisements violated Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act.²⁶⁴ Section 206(1) of the Advisers Act prohibits any investment adviser from, directly or indirectly, employing any device, scheme, or artifice to defraud any client or prospective client. Section 206(2) of the Advisers Act prohibits any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

Section 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act make it unlawful for any investment adviser to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative, including publishing, circulating or distributing any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading. No finding of scienter is required under Section 206(4) or Rule 206(4)-1(a)(5).²⁶⁵ Under Rule 206(4)-1(b), an advertisement is a written communication addressed to more than one person that

²⁶⁴ Valicenti Advisory Services, Inc., Investment Advisers Act Rel. No. 1774 (Nov. 18, 1998), aff'd, Valicenti Advisory Services v. Commission, 198 F.3d 62 (2d Cir. 1999).

²⁶⁵ Commission v. Steadman, 967 F.2d 636, 647 (D.C. Cir. 1992).

offers any investment advisory service for the purpose of inducing potential clients to subscribe to those services.²⁶⁶ As discussed above, ZPR used the magazine advertisements, ZPR newsletters, and Morningstar reports to solicit investors and accordingly, they are advertisements.²⁶⁷

1. The Magazine Advertisements and Newsletters

a. *ZPR Omitted Information Regarding Composite Performance Returns And Made False Statements That It Was GIPS Compliant*

ZPR violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder when it knowingly distributed advertisements to clients and prospective clients that disclosed its historic positive performance returns while omitting more recent performance returns as GIPS required. Truthful statements can be misleading when someone omits to state a material fact without which the truthful statement, based on the circumstances, becomes misleading.²⁶⁸ “[I]f a company chooses to make a statement on the subject, having chosen to speak, the company is obligated to make a full and fair disclosure.”²⁶⁹

When ZPR advertised its performance returns and stated that its advertisements were GIPS-compliant, it became obligated to speak fully about any material facts on that subject whose absence would make the advertisements misleading.²⁷⁰ In the October-December 2008

²⁶⁶ Commission v. C.R. Richmond & Co., 565 F.2d 1101, 1105 (9th Cir. 1977).

²⁶⁷ In the Matter of Groh Asset Management, Inc., et al., Admin. Proc. No. 3-11691, Advisers Act Rel. No. 2308, 2004 WL 2192394 (September 30, 2004) (finding that an investment adviser willfully violated Advisers Act antifraud provisions by disseminating materially false and misleading advertising and marketing materials to potential clients through third-party ranking publications and databases).

²⁶⁸ 17 C.F.R. § 240.10b-5 (in the context of Rule 10b-5); Ivax Corp., 920 F. Supp. at 967.

²⁶⁹ Harvey M. Jasper Retirement Trust v. Ivax Corp., 920 F. Supp. 1260, 1267 (S.D. Fla. 1995) (citing Dominick v. Dixie Nat'l Life Ins. Co., 809 F.2d 1559, 1571 (11th Cir. 1987)(once [defendant] undertook to speak, it was required to make a full and fair disclosure.”)).

²⁷⁰ *Id.*

advertisements,²⁷¹ April and December 2009 newsletters,²⁷² and February, March and May 2011 advertisements²⁷³ at issue, ZPR claimed GIPS compliance while failing to comply in these very advertisements with the GIPS advertising guidelines. These guidelines were mandatory because ZPR claimed GIPS compliance, and required ZPR to disclose, among other things, annual and period-to-date performance returns. ZPR failed to do this, and Zavanelli admitted during the final hearing that none of these magazine advertisements complied with GIPS.²⁷⁴ Therefore, each of these advertisements was false.

Additionally, ZPR selectively disclosed its performance returns in these advertisements while omitting negative performance return information. For the 2008 magazine advertisements, ZPR advertised its positive historic returns and touted that they outperformed ZPR's benchmark index. In truth, however, the more recent period, which GIPS required ZPR to disclose, reflected negative returns. Had ZPR disclosed performance returns for this period, the advertisements would have shown the truth – that ZPR was trading for negative returns in 2008 and underperforming its benchmark index. For the 2009 newsletter advertisements, ZPR failed to disclose the GIPS-required performance returns. Since GIPS requires the disclosure of one-year period returns, ZPR would have had to disclose the negative performance returns of 2008. However, ZPR chose to omit this negative information. Similarly, in the February, March, and

²⁷¹ DX 21 at 0005-7

²⁷² DX 8, DX 9

²⁷³ RX 15, RX 17, RX 19

²⁷⁴ Tr. 1662:6-1686:11; RX 15, 17, 19; DX 5-7.

May 2011 magazine advertisements, ZPR claimed GIPS compliance, which was false because the advertisements failed to disclose the three- and five-year returns GIPS required.²⁷⁵

b. The Omissions and Misstatements were Material

Materiality under the Advisers Act is defined by the same standard used under the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.²⁷⁶ A fact is material if there is a substantial likelihood that a reasonable client or prospective client would consider it important in making a decision because the fact would significantly alter the “total mix” of available information.²⁷⁷ “The test for materiality of an omission is ‘whether a reasonable man would attach importance to the fact omitted in determining a course of action.’”²⁷⁸

ZPR’s omissions of performance returns were material. ZPR’s negative performance returns and underperformance of its benchmark index during the most recent period is information a reasonable investor would have wanted to know in deciding whether to invest with ZPR. Similarly, ZPR’s false claim of GIPS compliance is material. As Zavanelli admitted, GIPS compliance is important to institutional investors.²⁷⁹ The GIPS standards were established based on the fundamental principles of full disclosure and fair presentation of a firm’s performance track record.²⁸⁰ In deciding whether to retain an advisory firm’s services, institutional investors consider whether an investment adviser is GIPS-compliant. The undisputed evidence showed that GIPS compliance is necessary to attract institutional investors,

²⁷⁵ Tr. 1662:6-1686:11; RX 15, 17, 19

²⁷⁶ Steadman, 603 F.2d at 1126, 1130.

²⁷⁷ Basic, Inc. v. Levinson, 485 U.S. 224, 232 (1988).

²⁷⁸ Merchant Capital, 483 F.3d at 768 (quoting Kennedy v. Tallant, 710 F.2d 711, 719 (11th Cir. 1983)).

²⁷⁹ Tr. 827:23-828:1.

²⁸⁰ DX 25, Introduction at Section I.D.

and ZPR began claiming GIPS compliance to lure them. Zavanelli admitted each of the advertisements claimed GIPS compliance, and each of the advertisements failed to comply with GIPS.²⁸¹ Clearly, institutional investors would have wanted to know that ZPR was not in truth complying with GIPS and was not making the full and fair disclosures of performance returns GIPS was established to ensure.

c. The Respondents Acted with Scienter

Scienter is required for a violation of Section 206(1), but not for Section 206(2), and can be satisfied by a showing of extreme recklessness.²⁸² Scienter has been described as “a mental state embracing intent to deceive, manipulate, or defraud.”²⁸³ Zavanelli’s scienter is imputed to ZPR.²⁸⁴

The evidence demonstrated Zavanelli and thus ZPR acted with the highest level of scienter because the misrepresentations and omissions concerning the performance returns and GIPS compliance were intentional. For example, the evidence showed:

- Zavanelli admitted he read the GIPS advertising guidelines beginning in 2006;
- Zavanelli admitted he approved the advertisements at issue;
- Zavanelli admitted he was responsible for deciding to make the statements that ZPR was GIPS compliant;
- In September 2008, Bauchle and Fay told Zavanelli the advertisement failed to comply with GIPS, but Zavanelli chose to run the advertisement any way;

²⁸¹

²⁸² See Steadman v. Commission, 603 F.2d 1126, 1134 (5th Cir. 1979), aff’d, 450 U.S. 91 (1981).

²⁸³ Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976).

²⁸⁴ *Insert*

- In 2008, Ashland told ZPR precisely why its advertisement failed to comply with GIPS and how to correct it, but ZPR ignored this advice, ran the advertisement with the same deficiencies at least 12 more times over the course of more than two years, and lied to Ashland to conceal the advertisements from its GIPS verification process by falsely representing ZPR was not advertising in magazines;
- Zavanelli only began omitting the performance returns GIPS requires in October 2008, after it suffered tremendous trading losses GIPS would have required it to reveal;
- Bauchle told Zavanelli the 2008 advertisements did not comply with GIPS, but Zavanelli made the decision to run the advertisements anyway and claim GIPS compliance in them;
- After the Commission told ZPR its advertisements were not GIPS-compliant because they failed to disclose the required performance returns in 2009, ZPR vowed to take corrective action and disclose the performance returns, then failed to do that and repeated the same violations in 2011;
- Ashland advised ZPR of the GIPS advertising rules at least five times and ZPR nonetheless published advertisements that failed to meet these requirements;
- Zavanelli admitted that had ZPR disclosed the performance returns GIPS required, it would have shown negative performance returns instead of the positive ones he advertised; and
- To prevent the Commission from learning about ZPR's misconduct, Zavanelli directed the destruction of evidence and withholding of evidence to obstruct the examination and investigation in this case.

This evidence demonstrates Zavanelli and ZPR acted with the highest degree of scienter. The Law Judge should also take into consideration Zavanelli's demeanor and credibility during the final hearing. As the Law Judge pointed out during Zavanelli's testimony, he was argumentative with Division counsel.²⁸⁵ He was also evasive on the stand and provided testimony that was not credible, including that he did not know there was a pending Commission investigation when the evidence showed to the contrary.

Accordingly, the Law Judge should find the Respondents' misrepresentations and omissions in the newsletters and magazine advertisements violated the Advisers Act.

2. ZPR's Morningstar Reports

a. ZPR Made False Statements in its Morningstar Reports

In October 2010 and April 2011, ZPR made false and misleading claims in Morningstar reports that Ashland had verified ZPR's performance results and that ZPR was not under a current Commission investigation.²⁸⁶ Ashland did not verify ZPR's performance results. Instead, Ashland had verified ZPR's compliance with GIPS requirements. Further, Ashland had not verified ZPR for GIPS compliance since 2009 and when ZPR ran these Morningstar advertisements, Ashland had terminated ZPR for its failure to comply with GIPS.²⁸⁷ When ZPR executed the Morningstar report for the period ended September 30, 2010, ZPR did not have any GIPS compliance verifier because Ashland terminated ZPR effective immediately and ZPR did not hire a new verifier until November or December 2010.²⁸⁸ In addition, when ZPR caused

²⁸⁵ Tr 768:19-769:769:16

²⁸⁶ DX 10 and DX 11

²⁸⁷ DX 36

²⁸⁸ DX 36; DX 89 at 161:21-23

these Morningstar reports to be published, ZPR knew it was under a pending Commission investigation. Accordingly, its statements to potential investors that there was no pending Commission investigation were false.

b. The False Statements Were Material

Clearly, under these circumstances a reasonable investor would find it important that ZPR was under a Commission investigation. Further, a reasonable investor would have wanted to know that contrary to ZPR's representations, Ashland had not verified ZPR's performance returns and had not conducted a GIPS compliance verification since 2009. As discussed above and as Zavanelli admitted during the final hearing, institutional investors place great importance on GIPS compliance when deciding whether to invest with an investment adviser.

c. ZPR Acted with Scienter

ZPR and Zavanelli knew the statements about the Commission investigation and performance return verifications were false when they made them. When ZPR created the first Morningstar report in October 2010, it had already received written notification from the Commission of the investigation. By the time ZPR created the second Morningstar report in April 2011, ZPR had hired attorneys in the Commission investigation and ZPR employees were testifying. During the testimony, the Commission stated the testimony was in connection with its investigation of ZPR. Nonetheless, ZPR advertised that there was no investigation.

The Respondents also knew Ashland had not verified ZPR's performance returns, had not performed work since 2009, and had in fact terminated the relationship with ZPR due to ZPR's failure to comply with GIPS. Nonetheless, the Respondents advertised that Ashland had verified performance returns in 2010.

Thus, the Respondents acted with scienter and the Law Judge should find the false Morningstar reports violated the Advisers Act.

**B. Zavanelli's Violations and/or Aiding and Abetting ZPR's Violations
of Sections 206(1), 206(2) and 206(4) of the Advisers Act and
Rule 206(4)-(a)(1)(5) Thereunder**

The Law Judge should find Zavanelli liable for primary violations, as set forth above. In the alternative, however, the Law Judge should find he aided and abetted ZPR's violations. Aiding and abetting violations of the securities laws involves three elements: (1) a primary violation by another party; (2) a general awareness by the aider and abettor that his role was part of an overall activity that was improper; and (3) the aider and abettor knowingly and substantially assisted in the conduct that constituted the primary violation.²⁸⁹

The awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant.²⁹⁰ To "substantially assist" a securities violation, a respondent must: (1) in some way associate himself with the venture; (2) participate in it as something that he wished to bring about; and (3) have sought by his action to make it succeed.²⁹¹ The Division establishes substantial assistance by showing a respondent "joined the specific venture and shared in it, and that his efforts contributed to its success, or, in other words, by showing that the defendant consciously assisted the commission of the specific [violation] in some active way."²⁹² The substantial assistance element is met when, based upon all the

²⁸⁹ Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1009 (11th Cir. 1985).

²⁹⁰ Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990).

²⁹¹ Commission v. Apuzzo, 689 F.3d 204, 206 (2d Cir. 2012).

²⁹² Commission v. DiBella, 587 F.3d 553, 566 (2d Cir. 2009) (internal citation omitted).

circumstances surrounding the conduct in question, a respondent's actions are "a substantial causal factor" in bringing about the primary violation.²⁹³

The evidence shows that Zavanelli knew ZPR's advertisements were false and misleading. He has admitted the magazine advertisements do not comply with the GIPS advertising guidelines and that he knew those guidelines at the time he approved the advertisements. Zavanelli testified he was primarily responsible for creating and drafting the advertisements in question and the information that went in them, including the 2008 and 2011 magazine advertisements, the newsletters, and the information provided to Morningstar. He admitted he made the final decision to claim GIPS compliance in the advertisements and was aware of the GIPS requirements. He owned the firm, ran the firm and was, as Bauchle testified, "the boss man." He decided to run advertisements claiming GIPS compliance even after Bauchle told him the advertisements did not meet the GIPS advertising guidelines. He also knew the misleading advertisements would be distributed to clients and prospective clients. With respect to the 2008 magazine advertisements, Zavanelli was aware that ZPR's Small Cap Composite was underperforming its benchmark index, and that the advertisements omitted more recent period-to-date performance returns. The evidence also shows that Zavanelli knew that providing period-to-date performance returns in the advertisements would reveal the fact that ZPR was underperforming the benchmark index. This conclusion is supported by the fact that in 2007, when ZPR had been outperforming its benchmark, the firm's advertisements included period-to-date figures. With respect to ZPR's false claims of GIPS compliance in the magazine advertisements and client newsletters, the evidence shows that Zavanelli knew, or was reckless

²⁹³ Woods, 765 F.2d at 1013.

in not knowing, that the information in the advertisements concerning ZPR's compliance with GIPS, among other things, was false and misleading. Zavanelli testified that he knew and understood the GIPS advertising guidelines.

Accordingly, Zavanelli violated or, in the alternative, aided and abetted and caused ZPR's violations of Sections 206(1) and 206(2) of the Advisers Act, and aided and abetted and caused ZPR's violations of 206(4) of the Advisers Act and Rule 206(4)-1(a)(5), thereunder.

C. Adverse Inference

The Division seeks an adverse inference against the Respondents based both on their intentional withholding of evidence and the spoliation of same.

1. The Respondents' Intentionally Withheld Documents and Obstructed the Examination and Investigation

a. The Portal

It is undisputed that during the examination and investigation of ZPR, the firm failed to produce any documents from its portal,²⁹⁴ which is an electronic communications system²⁹⁵ ZPR employees have used on a daily basis to operate the company since approximately 2003 or 2004.²⁹⁶ ZPR employees used the portal to carry out the majority of ZPR's operations and to send communications regarding trading, daily reports, client portfolios, performance returns, and market activity, potential clients, communications to potential and existing clients, and GIPS compliance and advertising matters.²⁹⁷ Fay used the portal to communicate with Zavanelli concerning GIPS

²⁹⁴ Tr. 464:11-22.

²⁹⁵ Tr. 801:10-24.

²⁹⁶ Tr. 146:11-24; 148:1-3; 150:25-151:14.

²⁹⁷ Tr. 150:10-19; DX 98-157.

compliance.²⁹⁸ Fay produced no documents from the portal.²⁹⁹ Sappir used the portal beginning in 2007, and his primary job was soliciting clients and answering clients' questions about ZPR, including questions about GIPS compliance.³⁰⁰ However, he too withheld all portal documents after receiving the Commission's subpoena.³⁰¹ Zavanelli directed ZPR employees to communicate through the portal,³⁰² the purpose of which was to keep ZPR's communications confidential from third parties, including the Commission,³⁰³ and then directed Bauchle to withhold these documents from ZPR's productions to the Commission.³⁰⁴

When the first portal was in use prior to March 2011, the communications were saved to a server and ZPR employees could retrieve the communications to produce them.³⁰⁵ However, the Respondents did not produce a single document from the portal.³⁰⁶ Instead, as discussed below, they misled the Commission and falsely stated that there was a portal but it did not contain any books and records.³⁰⁷

While the portal documents were available during the examination and investigation of this case, ZPR has since lost all portal documents created prior to March 2011. In other words, the portal documents for the time period relevant to this case – which alleges misconduct from 2008

²⁹⁸ Tr. 1237:11-1238:24; DX 129.

²⁹⁹ Tr. 1239:4-1240:17.

³⁰⁰ Tr. 1170:3-1171:5; DX 121.

³⁰¹ Tr. 1181:10-1182:10.

³⁰² 175:24-176:2.

³⁰³ Tr. _ (Bacuhle); DX 101.

³⁰⁴ Tr. 151:15-153:9; 172:17-173:11; 176:17-177:6; 179:14-180:25.

³⁰⁵ Tr. 335:11-336:24.

³⁰⁶ Tr. Bauchle, Tr. 445:5-446:25, 575:4-576:18.

³⁰⁷ RX 43

until 2011 – are gone. These documents no longer exist because ZPR failed to maintain its electronic communications as the Investment Adviser Act requires. Notably, while ZPR now claims they lost their portal communications in March 2011, they failed to advise the Commission of this during the investigation despite the Commission’s request for that information.³⁰⁸

The first time ZPR produced any portal document was when it exchanged its final hearing exhibits with the Commission in August 2013. The first time the Commission learned these exhibits were portal documents and that any responsive portal documents existed was when Bauchle told the staff the night before the final hearing commenced.³⁰⁹ Communications from the portal are identified with the syntax “name/zpr,” “name/zpr@zpr,” or “zprintl.”³¹⁰ ZPR International, which Zavanelli owns, owned both versions of the portal.³¹¹

During the final hearing, the ALJ permitted the Commission to subpoena ZPR for the withheld responsive portal documents. In response, ZPR produced 850,000 portal communications they had never before produced.³¹² However, this production did not include any documents prior to March 2011 because such portal documents are now lost.³¹³ Since Zavanelli communicated exclusively through the portal, the Commission has no evidence of his communications concerning the false and misleading advertising advertisements at issue, ranging from 2008 until 2011, because ZPR failed to produce them and failed to preserve them.

³⁰⁸ RX 42; DX 92.

³⁰⁹ Tr. (Bauchle)

³¹⁰ Tr. 745:19-22; RX 9, 10, 27; Tr. 161:12-165:24; DX 112; Tr. 818:5-8.

³¹¹ Tr. 175:9-176:2.

³¹² Opposing counsel stated this at the final hearing when the Law Judge asked if they had previously been produced.

³¹³ Tr. 149:20-150:9; 333:10-15.

b. ZPR Knew The Consequences of Withholding Documents

On January 14, 2009, the Commission provided ZPR with Forms 1661 and 1662, which explained to ZPR the consequences of withholding documents the Commission subpoenaed and ZPR's books and records.³¹⁴ These forms advised the Respondents that the potential consequences for withholding documents included monetary penalties, imprisonment, censure or expulsion from registration, and an injunction.³¹⁵ With full knowledge of these consequences for withholding these documents, ZPR, at Zavanelli's direction, did just that.

c. ZPR Failed to Produce Electronic Communications the Commission Requested During the Examination

i. They Withheld Electronic Communications Requested for the Time Period of the False and Misleading Advertisements

On February 3, 2009, the Commission sent ZPR a request for documents seeking, among other things, the following documents in connection with the Commission's examination of ZPR:

12. All electronic communications ("email") sent and received for the period of July 1, 2008 through December 31, 2008 for:

- a. Max Zavanelli
- b. Ted Bauchle
- c. Ruth Ann Fay.³¹⁶

It is undisputed that ZPR failed to produce any responsive documents from the portal. However, such responsive documents did exist. Bauchle testified that there were responsive documents on the portal and Zavanelli told him not to produce them. Zavanelli admitted he used the portal to operate ZPR, Bauchle testified he communicated through the portal on a daily basis,

³¹⁴ RX 42 at p.15, Section C, and p.19, Tr. 451:8-452:6.

³¹⁵ *Id.*

³¹⁶ RX 42 at p.30

and Zavanelli admitted Fay had access to email through the portal during the relevant time period. However, ZPR did not produce them and instead lied to the Commission about the portal messages.

On February 4, 2009, ZPR sent a written response to the Commission's request for documents that specifically addressed request number 12 for electronic communications.³¹⁷ In it, ZPR advised the Commission that there was a portal, but it "is not used for any of the categories covered by Rule 402-2."³¹⁸ As set forth more fully below, this was patently false.³¹⁹ ZPR's lie had the intended effect, as Cabot testified that she understood ZPR's response to mean the portal did not contain any communications relevant to ZPR's business.³²⁰ As Zavanelli admitted, however, this was simply not the case. Instead, the portal was the primary method of communication among ZPR employees and Zavanelli used the portal to operate ZPR.

The portal communications would have been relevant to the claims at issue in this case. In the OIP, the Commission alleged, among other things, that ZPR engaged in false and misleading advertising from October through December 2008.³²¹ The Commission sought communications for this time period, as set forth above. Zavanelli used the portal "to stay in communication with everyone and all [of his] companies."³²² Zavanelli sent communications through the portal concerning ZPR's GIPS verification process.³²³ He also used the portal to review the performance

³¹⁷ RX 43 at p.9

³¹⁸ *Id.*

³¹⁹ RX 9 and 10

³²⁰ Tr.

³²¹ DX 1

³²² Tr. 803:10-12.

³²³ Tr. 826:8-828:1.

returns,³²⁴ obtain copies of ZPR's records,³²⁵ direct trades for ZPR,³²⁶ tell ZPR what to sell in ZPR's portfolio and when to sell it,³²⁷ and direct ZPR's traders.³²⁸

Additionally, until Zavanelli terminated Bauchle in April 2013, Bauchle sent his daily trading reports to Zavanelli through the portal and began sending them to Mark Zavanelli through the portal as well once he became president of ZPR in late 2011.³²⁹ Zavanelli also used the portal to communicate with potential investors about ZPR.³³⁰ For example, on December 9, 2011, Zavanelli sent a portal message to Mark Fidelak, a German broker, in which he stated, "Delighted to talk to you today and look forward to a long and successful relationship," and went on to tell Fidelak that Heidi, the ZPR employee responsible for sending information to potential clients, would send him the ZPR trading strategy, May 2011 ZPR advertisement in *Pensions and Investments*, and ZPR's institutional presentation."³³¹ Zavanelli admitted these documents all relate to ZPR, but claimed he was soliciting Fidelak through the portal for ZPR International and not ZPR. The Law Judge should find this *not* credible. The message clearly shows, and Zavanelli admits, the message and all of the documents he is sending concern ZPR and not ZPR

³²⁴ Tr. 803:10-22.

³²⁵ Tr. 803:10-22.

³²⁶ Tr. 803:10-22.

³²⁷ Tr. 823:17-20; DX 114.

³²⁸ DX 114; Tr. 824:12-826:7.

³²⁹ Tr. 813:6-814:8.

³³⁰ DX 110

³³¹ DX 110

International.³³² Regardless, however, the evidence showed the portal contains communications concerning soliciting new clients.

Further, in an October 14, 2011 portal message from Fay to ZPR employees and Petrauskas, Fay advised that clients and third party vendors could be contacted through the portal if Zavanelli was included in the communication.³³³ Not only did Fay's message refer to this as a ZPR rule, but also the Division presented evidence that ZPR sends communications to its clients and copies Zavanelli via the portal.³³⁴ For example, on September 7, 2012, Mark Zavanelli sent a message to a ZPR client and copied Zavanelli on the portal.³³⁵ Further, ZPR investors and potential investors contacted Zavanelli through the portal.³³⁶ For example, on September 7, 2012, a ZPR investor contacted Zavanelli to indicate he wanted to invest in a new strategy ZPR promoted in its Investment Report.³³⁷

The portal also contains client complaints. For example, on August 1, 2012, Mark Zavanelli sent Zavanelli a message through the portal concerning a ZPR client complaint.³³⁸ Mark Zavanelli attached to the portal message a letter from the Commission forwarding a complaint from a ZPR investor and a letter from a United States Congressman concerning this client's complaint.³³⁹ Zavanelli also used the portal to communicate about GIPS verification.³⁴⁰

³³² Tr. 804:8-808:1.

³³³ *Id.*

³³⁴ DX 112

³³⁵ DX 112; 817:20:818:15.

³³⁶ DX 112; 817:20-820:9.

³³⁷ *Id.*

³³⁸ DX 113.

³³⁹ DX 113

However, ZPR withheld all of its portal messages, and has now lost messages from prior to March 2011 due to ZPR's failure to comply with the email and books and records preservation requirements of Advisers Act Rules 204(e)(1) and (g). The Law Judge should infer an adverse inference against the Respondents for withholding these documents, obstructing the examination and investigation that led to this action, and spoliation of these documents.

ii. ZPR Withheld Information about Service Providers and Electronic Access the Commission Requested

In early 2009, the Commission also requested information concerning all service providers and the services they provide,³⁴¹ as well as electronic access authorization and service providers.³⁴² ZPR failed to provide information or documents concerning service providers for the portal and electronic access to the portal.³⁴³

iii. ZPR Failed to Produce the Books and Records the Commission Requested

On January 14, 2009, the Commission sent ZPR a Form 1661, which set forth all of the documents ZPR was required to provide the Commission in connection with the Commission's examination 2009 examination.³⁴⁴ This included all categories of documents meeting the definition of books and records under Rule 204-2 of the Investment Advisers Act.³⁴⁵

Pursuant to Rule 204-2(a)(7), communications concerning trades and advertisements are included in the definition of books and records. That Rule provides as follows:

³⁴⁰ DX 115, 118, 129.

³⁴¹ RX 42 at p.7, Item K.

³⁴² RX 42 at p.9, Item iii

³⁴³ Tr. (Cabot)

³⁴⁴ RX 42 at p.15, Tr. 448:2-19, 450:2-25.

³⁴⁵ RX 42 at p.15, Section B1, Tr. 448:2-19, 450:2-25.

(7) Originals of all written communications received and copies of all written communications sent by such investment adviser relating to *(i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, or (iii) the placing or execution of any order to purchase or sell any security*: *Provided, however, (a) That the investment adviser shall not be required to keep any unsolicited market letters and other similar communications of general public distribution not prepared by or for the investment adviser, and (b) that if the investment adviser sends any notice, circular or other advertisement offering any report, analysis, publication or other investment advisory service to more than 10 persons, the investment adviser shall not be required to keep a record of the names and addresses of the persons to whom it was sent; except that if such notice, circular or advertisement is distributed to persons named on any list, the investment adviser shall retain with the copy of such notice, circular or advertisement a memorandum describing the list and the source thereof.*

Rule 204-2(a)(7) (emphasis added).

Zavanelli admitted he directed ZPR's trades and sent trading instructions through the portal³⁴⁶ and that Bauchle sent him daily trading and performance return reports through the portal.³⁴⁷ However, ZPR, at Zavanelli's direction, did not produce any portal documents to the Commission.

Rule 204-2(a)(11) includes in the definition of books and records all advertisements and states as follows:

(11) A copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser), and if such notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication recommends the purchase or sale of a specific security and does not state the reasons for such recommendation, a memorandum of the investment adviser indicating the reasons therefor.

³⁴⁶ Tr. 803:10-22, 823:17-20; 824:12-826:7.

³⁴⁷ Tr. 813:6-814:8.

Bauchle testified the portal contained copies of advertisements and investment letters ZPR distributed, and more recent portal messages demonstrate ZPR employees have used the portal to communicate about and send copies of ZPR's advertisements.³⁴⁸ Correspondence concerning marketing and trading, which Bauchle testified were on the portal, also meet the books and records definition of Rule 204-2.³⁴⁹ The Commission also made a separate request for all advertisements on January 14, 2009, in addition to seeking books and records.³⁵⁰ However, ZPR, at Zavanelli's direction, withheld all portal documents during the Commission's examination.

Rule 204-2 also includes in the definition of books and records all records necessary to form the basis of or demonstrate performance returns. Specifically, Rule 204-2(a)(16) provides as follows:

(16) All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser); provided, however, that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph.

Zavanelli admitted Bauchle sent him daily messages through the portal attaching trading and performance return reports.³⁵¹ However, ZPR, at Zavanelli's direction, withheld all portal

³⁴⁸ RX 9; Tr. 460:14-463:12; RX 10; Tr. 463:13-464:10.

³⁴⁹ *Id.*

³⁵⁰ RX 42 at p.12, Section IV.

³⁵¹ Tr. 813:6-814:8.

communications during the examination.³⁵² Zavanelli then lied during his investigative testimony and testified there was “nothing withheld,” despite knowing this sworn testimony was false.³⁵³

*d. ZPR Withheld Responsive Documents from the Commission
During the Investigation*

ZPR also withheld portal documents responsive to the Commission’s requests for documents during the investigation. Three years ago, in August 2010, the Commission requested ZPR’s advertisements and marketing materials in connection with the investigation.³⁵⁴ The portal contained such documents.³⁵⁵ ZPR did not produce them. The Commission also sought documents relating to ZPR’s Small Value Cap Composite concerning the Composite performance.³⁵⁶ The portal contained daily performance return reports.³⁵⁷ ZPR did not produce them.

On October 27, 2010, the Commission requested, among other things, any and all documents concerning client complaints.³⁵⁸ ZPR used the portal to communicate about client complaints. For example, on August 1, 2012, Mark Zavanelli sent Zavanelli a message through the portal concerning a ZPR client complaint.³⁵⁹ Mark Zavanelli attached to the portal message a letter from the Commission forwarding a complaint from a ZPR investor and a letter from a United

³⁵² Tr. (Bauchel), Tr. 445:5-446:25, 575:4-576:18..

³⁵³ DX 89 at 8:17-9:1.

³⁵⁴ DX 92 at p.2, item 7

³⁵⁵ DX 9 and 10, Tr (Bauchle)

³⁵⁶ DX 92 at p.2, item 8.

³⁵⁷ Tr. (Bauchle)

³⁵⁸ DX 92 at p.6, item 6.

³⁵⁹ DX 113.

States Congressman concerning this client's complaint.³⁶⁰ However, ZPR failed to produce any portal documents to the Commission.

The Commission also sought supporting documentation, including trade reports, for the Small Cap Value Composite.³⁶¹ Bauchle testified he sent trade reports to Zavanelli every day using the portal. However, ZPR failed to produce any such documents.

The Commission's requests directed ZPR to produce a log of any responsive documents it withheld and the reasons why the materials were withheld.³⁶² ZPR did not produce such a log or otherwise advise the Commission it was withholding portal documents.

*e. Zavanelli Provided False and Misleading Testimony to
Keep the Portal Off the Commission's Radar*

During his June 13, 2011 investigative testimony, Zavanelli continued to conceal the portal documents from the Commission by lying about his email address. Specifically, he testified as follows:³⁶³

³⁶⁰ DX 113

³⁶¹ DX 92 at p.6, item 9.

³⁶² DX 92 at pp.4, 7.

³⁶³ Tr. 89 at 9-10

10 Q Do you have any e-mail address you use to
11 conduct ZPR business?

12 A We have ZPR Investment Management.

13 Q When we say ZPR today, we will be talking
14 about Investment Management unless we clarify
15 otherwise.

16 A Thank you.

17 No.

18 We have an internal e-mail system that's
19 worldwide for ZPR International.

20 Q What is the internal e-mail address?

21 A Max@zprinternational.com. It is actually
22 zprintl. ←

Zavanelli's portal address.

23 Q Are there any other e-mail addresses that
24 you use to conduct ZPR business?

25 A No.

1 All our ZPR Investment Management business
2 is through the zprintl.net e-mail address.

3 Q Who has access to that e-mail address?

4 A All people in our company.

5 Q Can you repeat that again?
6 ZPR?

7 A I have to look it up.

8 Zprintl.net. ←

Zavanelli's portal address.

9 Q Do you use this e-mail address?

10 A Let me give you the correct address. I have
11 it.

12 It is zprim.net. ←

Not the portal address.

Thus, Zavanelli initially disclosed his email as printl.net, which is the portal through which he operated the company and his true email address.³⁶⁴ After realizing what he had done, he changed his testimony to provide what he claimed was the correct address, zprim.net. This was a

³⁶⁴ Tr. 1655:17-1656:23.

lie. Zavenelli admitted at the final hearing that he has never had a zprim.net email address.³⁶⁵ Thus, he lied during the investigation to further conceal the portal from the Commission.

f. During the Investigation, Zavenelli Directed the Destruction of Evidence

On October 27, 2010, the Commission investigation staff sent ZPR a document request letter and Form 1661 notifying ZPR that it must make all of its records available for inspection by the Commission. As discussed above, the Investment Advisers Act specifies ZPR must preserve electronic communications and books and records. However, Zavenelli directed the destruction of portal communications.

In March 2011, when Zavenelli was aware of the Commission's investigation, he directed Bauchle to delete information concerning accounts from the ZPR computers.³⁶⁶ In March 2011, Zavenelli wrote to Bauchle through the portal to destroy this evidence and limit all communications with ZPR's international companies and clients to the portal because he had successfully shielded the portal from the portal was off limits to the Commission.³⁶⁷ Specifically, Zavenelli directed Bauchle as follows:

Please send Diva the MMGR and all historical data, and then *delete them from the computers. There is always the possibility that the Commission will try to seize all our U.S. computers, which is one of the ways they work.* We need to keep ZPR International business completely away from our computers in the U.S., not allow the U.S. office to even do convenient things like pricing our German portfolios at the end of the day of the U.S. market. *Always direct all communications to our international companies and clients in the new portal, which is off the radar of the prying eyes of the Commission monster.*³⁶⁸

³⁶⁵ Tr. 1657:9-1658:7

³⁶⁶ Tr. 770:22-771:1; 771:15-18.

³⁶⁷ DX 101, Tr. 771:2-12.

³⁶⁸ DX 101 (emphasis added)

Zavanelli testified that he could not remember whether or not he told people to delete portal message so the Commission would not obtain them.³⁶⁹ However, the evidence showed he did just that. On June 19, 2012, Zavanelli sent David Sappir a portal message directing him to delete portal messages from a ZPR pension fund client.³⁷⁰ Sappir testified at the final hearing that he probably followed Zavanelli's instructions and deleted the portal messages.

Zavanelli believed the portal was "off the radar of the Commission monster"³⁷¹ and therefore during the investigation he directed ZPR employees to use the portal because he believed the Commission would not obtain portal messages.³⁷² For example, in mid-2011, Zavanelli knew the Commission's investigation was ongoing because the Commission took his testimony on June 13, 2011.³⁷³ On August 12, 2011, Zavanelli directed Mark Zavanelli, who was then president of ZPR, to "use only the ZPR portal... and not your outside email address above, which is not secure and confidential."³⁷⁴ In August 2011, Zavanelli directed Mark Zavanelli to "use only the portal... on anything with ZPR" and told him this was "extremely important."³⁷⁵ On October 13, 2011, Mark Zavanelli advised Zavanelli that he "set up non-portal email addresses based on the zprim.com domain" for the ZPR employees.³⁷⁶ Zavanelli responded by telling Mark Zavanelli that "everyone should be aware that zprim emails are available to the Commission and they did ask for

³⁶⁹ Tr 780:25-781:6.

³⁷⁰ DX 103, Tr.781:15-783:15.

³⁷¹ DX 101

³⁷² DX 101, 104

³⁷³ 794:7-9; DX 89

³⁷⁴ DX 104

³⁷⁵ DX 107

³⁷⁶ DX 105

all zprim emails.”³⁷⁷ On November 17, 2011, Zavanelli emailed Fay and Mark Zavanelli to “use only the portal addresses” in their discussions with Zavanelli about ZPR.³⁷⁸ Zavanelli knew the investigation was ongoing when he sent these messages.³⁷⁹

g. Zavanelli also Threatened a Witness

Zavanelli also threatened a witness in this case concerning their investigative testimony.³⁸⁰ While the threat did not concern the portal, it reflects Zavanelli’s bad faith concerning the full disclosure of evidence in this case. After Bauchle testified in the investigation, Zavanelli sent him an email threatening Bauchle with “a very long and expensive court fight.”³⁸¹ Zavanelli terminated Bauchle the week after the Commission instituted this action.³⁸² Zavanelli told Sappir Bauchle had betrayed him.³⁸³ Nonetheless, Bauchle’s testimony during the final hearing was consistent with his investigative testimony.³⁸⁴

h. After Becoming President, Mark Zavanelli Learned ZPR did not Produce the Portal Documents and at No Time Did He Raise This With the Commission or Take any Corrective Action

During the Commission’s investigation Mark Zavanelli learned ZPR failed to produce portal messages.³⁸⁵ On September 9, 2011, Fay wrote to Mark Zavanell, advised him ZPR produced no portal messages in response to the Commission’s request for electronic

³⁷⁷ *Id.*

³⁷⁸ DX 106; Tr. 792:21-793:15.

³⁷⁹ 794:15-18.

³⁸⁰ DX 102.

³⁸¹ *Id.*

³⁸² Tr. 139:21-141:2; 142:22-143:2; 413:18-415:4; DX 102.

³⁸³ DX 123.

³⁸⁴ Bauchle

³⁸⁵ DX 130.

communications, and stated, “I wonder if they had the talent to hack it.”³⁸⁶ The investigation continued for more than another year with Mark Zavanelli at the helm of ZPR as president, and at no time did he mention the portal or take any action to correct or supplement the prior productions. Of the 850,000 portal messages ZPR produced during the final hearing, *none* had previously been produced.

2. The Standard for Obtaining an Adverse Inference

The adverse inference rule “provides that when a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him.” *Int’l Union, UAW v. NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972). As discussed below, the portal messages ZPR, at Zavanelli’s direction, withheld from the Commission during the examination and investigation are relevant to the instant case and accordingly, the Law Judge should infer an adverse inference against the Respondents.

The portal communications existed when the Commission sought them during the examination and investigation in 2009 and 2010. However, in 2011, after ZPR failed to produce the portal communications, ZPR lost them. The Law Judge may infer an adverse inference based on this spoliation of evidence. An adverse inference is appropriate when relevant documents are lost or destroyed due to the gross negligence of a party. *Reilly v. Natwest Markets Group, Inc.*, 181 F.3d 253, 267–68 (2d Cir.1999), *cert. denied*, 528 U.S. 1119, 120 S.Ct. 940, 145 L.Ed.2d 818 (2000). An adverse inference from the destruction of evidence can only arise if the party with control over the evidence had an obligation to preserve it when it was destroyed. *Kronisch v. United States*, 150 F.3d 112, 126–27 (2d Cir. 1998). Furthermore, there must be “some showing

³⁸⁶ *Id.*

indicating that the destroyed evidence would have been relevant to the contested issue.” *Id.* at 127 (citations omitted). As set forth above, all portal communications prior to March 2011 have been lost or destroyed and the communications are relevant to this action. Further, ZPR had an obligation to preserve them.

Rule 204-2(g) of the Investment Advisers Act requires ZPR to maintain and preserve electronic communications. Zavanelli admitted ZPR failed to do that. Further, Rule 204(e)(1) requires as follows:

All books and records... shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the investment adviser.

Bauchle testified ZPR could access the portal messages during the period when the Commission requested them. Indeed, he asked Zavanelli if he could produce them to the Commission, and Zavanelli directed him not to do so. Zavanelli admitted ZPR failed to store or maintain the portal messages until at least March 2011, and Fay admitted ZPR has never had a policy for maintaining the portal messages. Zavanelli now claims a ZPR lost the portal messages when a third party in Cambodia took them in March 2011 – years *after* the Commission requested them in the examination and *after* ZPR produced documents responsive to the Commission’s requests for documents in the examination and investigation. The evidence showed Zavanelli made a single attempt to obtain the portal messages by sending a request letter, and admits he never took any further action to obtain them. The fact that a third party purportedly took the portal messages in March 2011 does not cure the Respondents’ failure to produce them, as their productions in the examination and investigation, and their willful failure to produce portal messages occurred before then. The subsequent loss of the portal messages weighs in favor of inferring an adverse action

because as a result of ZPR's failure to produce them and to preserve these documents pursuant to the Advisers Act results in a situation where all electronic portal messages for the relevant time period in this case are no longer available. We will never know what Zavanelli and ZPR communicated about the advertisements at issue – which is precisely what the Respondents intended.

Accordingly, all elements for inferring an adverse inference against ZPR and Zavanelli are present here and the Law Judge should infer that had the Respondents produced the portal communications, they would have been adverse to their defense in this case.

X. REMEDIES

A. The Law Judge Should Impose Cease-And-Desist Orders

Sections 15(b) and 21C of the Exchange Act and Section 8A of the Securities Act empower the Commission to order a person who has been found, after notice and hearing, to have violated or caused any violation of those Acts, to cease and desist from committing or causing such violations and any future violations.

The factors for considering whether a cease-and-desist order is warranted are very similar to the factors set forth in Steadman v. Commission, 603 F.2d 1126, 1140 (5th Cir. 1979), with added emphasis on the possibility of future violations.³⁸⁷ The *Steadman* factors are: (1) the egregiousness of a respondent's actions; (2) the isolated or recurrent nature of his securities law infractions; (3) the degree of scienter involved; (4) the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of his conduct; and (6) the

³⁸⁷ *In the Matter of KPMG Peat Marwick, LLP*, AP File No. 3-9500, 2001 WL 47245 at *23-26 (Jan. 19, 2001), *aff'd sub nom KPMG v. Commission*, 289 F.3d 109 (D.C. Cir. 2002).

likelihood the respondent's occupation will present opportunities for future violations.³⁸⁸ No one factor controls.³⁸⁹ The severity of the sanction appropriate in a particular case depends on the facts of the case and the value of the sanction in preventing recurrence.³⁹⁰

All of these factors weigh in favor of the Law Judge imposing a cease-and-desist order on Zavanelli and ZPR. Their actions were highly egregious. They repeatedly made misrepresentations and omissions and engaged in deceptive conduct to conceal ZPR's negative performance returns and lure institutional investors with the false claim of GIPS compliance. Their misleading advertisements were designed to attract investors to invest in ZPR based on its positive performance returns and overperformance of ZPR's benchmark index, when in truth ZPR was trading for negative returns and underperforming the index. They advertised their GIPS compliance verification while knowing these same advertisements were not GIPS compliant, concealed the truth about ZPR's performance, and that the verification was bogus because Ashland's verification review did not include ZPR's non-compliant advertisements. They intentionally concealed their advertisements from Ashland so they could continue to obtain and advertise GIPS compliance to institutional investors who only invest with GIPS-compliant firms. And they lied to make this happen by telling Ashland they were not advertising, when the opposite was true. They also lied about the Commission's investigation against ZPR to continue luring investors.

Zavanelli and ZPR knew their advertisements failed to comply with GIPS because the

³⁸⁸ *Steadman*, 603 F.2d at 1140.

³⁸⁹ *Commission v. Fehn*, 97 F.3d 1276, 1295-96 (9th Cir. 1996).

³⁹⁰ *Berko v. Commission*, 316 F.2d 137, 141 (2nd Cir. 1963); *In the Matter of Leo Glassman*, AP File No. 3-3758, 1975 WL 160534 at *2 (Dec. 16, 1975).

Commission and Ashland told them. ZPR promised to take corrective action and then swiftly violated GIPS in the same exact manner over and over again. ZPR and Zavanelli engaged in this conduct for purely selfish reasons – ZPR’s financial interests. ZPR was financially weak when ZPR began this scheme and had profits of less than \$7,000 a year. ZPR and Zavanelli continued this scheme after 2008, when ZPR was so financially weak that it was borrowing money from Zavanelli to stay afloat. ZPR needed new clients, and so Zavanelli and ZPR falsely advertised to lure the institutional clients ZPR so desperately needed – without any regard for potential clients or the truth.

The actions were recurrent. The continued from October 2008 until May 2011 and involved a variety of misrepresentations and omissions. During these years, ZPR and Zavanelli distributed at least eleven false and misleading advertisements, and repeatedly ignored the advice of Ashland and the Commission to correct the advertisements. Moreover, ZPR and Zavanelli continued the misrepresentations about GIPS compliance and Ashland auditing ZPR after they assured the Commission the firm would take corrective steps to end this misconduct.

As discussed above, Zavanelli displayed the highest degree of scienter since he knew the facts he and ZPR were publicly disseminating were false. The Law Judge should also consider Zavanelli’s obstruction of the Commission’s examination and investigation in assessing his scienter. As to the fourth and fifth factors, ZPR and Zavanelli have not acknowledged the wrongfulness of their conduct. Nor have they given any assurances against future misconduct. While Zavanelli appointed his son, Mark Zavanelli, president of ZPR in November 2011, the evidence showed Mark Zavanelli has not corrected the misstatements in the Morningstar reports and took steps to perpetuate the same misstatements about the Commission’s investigation in those

reports in 2012. And then he lied at trial and claimed he did not know there was an investigation, despite overwhelming evidence to the contrary. In addition, Mark Zavanelli was president of ZPR during the investigation of this case, when ZPR withheld all portal documents from the Commission and obstructed the investigation. ZPR remains in business and has the opportunity to re-offend.

Further, Zavanelli admitted and the evidence showed he still directs Mark Zavanelli and makes all trading decisions for ZPR and thus continues his involvement. Finally, Zavanelli remains as a board member of ZPR and has worked exclusively in the investment adviser field since at least 1997. Therefore he has the opportunity to re-offend.

As all of the Steadman factors weigh in favor of a cease-and-desist order against ZPR and Zavanelli, the Law Judge should impose one.

B. The Law Judge Should Impose A Permanent Industry Bar Against Zavanelli

The same six *Steadman* factors apply to the consideration of an investment adviser and related industry bars against Zavanelli. Here, applying the *Steadman* factors as we did in the immediately preceding section weighs heavily in favor of permanently barring Zavanelli from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. The Commission has held conduct such as that of Zavanelli, which violates the antifraud provisions of the federal securities laws, “is especially serious and subject to the severest of sanctions under the securities laws.”³⁹¹

Here, the Division requests that the Law Judge collaterally bar Zavanelli from association

³⁹¹ In the Matter of Jose P. Zollino, AP File No. 3-11536, 2007 WL 98919 at *5 (Jan. 16, 2007).

with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization (“NRSRO”). Section 925 of the Dodd-Frank Wall Street Reform and Consumer Protection Act authorized the Commission to impose collateral bars in proceedings pursuant to Section 15(b) of the Exchange Act by amending Section 15(b)(6)(A) to “bar any such person from being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.”³⁹² The collateral bars Dodd-Frank authorized prohibit securities professionals found to have violated the securities laws from associating with any of the Commission-regulated entities specified in amended Exchange Act Section 15(b)(6)(A).

The Dodd-Frank Act’s collateral bar provisions are applicable here even though the statute was not enacted until July 21, 2010, after the date of some of the conduct at issue.³⁹³ However, Zavanelli also continued his violations even after the enactment of Dodd-Frank.

Law Judges in other matters against principals of regulated entities have imposed bars after making post-hearing findings of fraud.³⁹⁴ A collateral bar is an appropriate remedy against Zavanelli. His fraudulent conduct and obstruction to conceal it clearly warrant collaterally barring him from association with any regulated entity.

³⁹² P.L. 111-203 (July 21, 2010).

³⁹³ In the Matter of John W. Lawton, AP File No. 3-14162, 2012 WL 6208750 at *6-10 (Dec. 13, 2012) (Commission concluded Dodd-Frank collateral bar was not impermissibly retroactive and imposed such a bar).

³⁹⁴ See, e.g., In the Matter of Montford and Co., AP File No. 3-14536, 2012 WL 1377372 at *21 (April 20, 2012) (after a hearing, Law Judge found principal of advisory firm liable for Adviser’s Act fraud violations and imposed a permanent collateral bar); In the Matter of Gualario and Co., AP File No. 3-14340, 2012 WL 627198 at *18 (Feb. 14, 2012) (after a hearing, Law Judge found respondents acted as unregistered brokers and made fraudulent misrepresentations and omissions to investors and ordered collateral bars).

C. The Law Judge Should Impose Civil Money Penalties Against ZPR And Zavanelli

The Division also seeks the imposition of civil penalties against ZPR and Zavanelli pursuant to Section 203(i) of the Advisers Act. The purpose of civil penalties is to punish the individual violator as well as deter future violations.³⁹⁵ As set forth in H.R. Report No. 616 - the Report of the Committee on Energy and Commerce of the U.S. House of Representatives on the Remedy Act,

[T]he money penalties proposed in this legislation are needed to provide financial disincentives to securities law violations other than insider trading ... Disgorgement merely requires the return of wrongfully obtained profits; it does not result in any actual economic penalty or act as a financial disincentive to engage in securities fraud The Committee therefore concluded that authority to seek or impose substantial money penalties, in addition to the disgorgement of profits, is necessary for the deterrence of securities law violations that otherwise may provide great financial returns to the violator. (Citations omitted).³⁹⁶

Penalties against corporate entities are “essential” to the Commission’s enforcement program.³⁹⁷

The Exchange Act, 15 U.S.C. § 78u, provides for three tiers of penalties in administrative proceedings. Under the “First Tier,” the Law Judge may impose a penalty of up to (a) \$6,500 against an individual and \$65,000 against an entity for violations occurring between February 2005 and March 3, 2009, or \$7,500 against an individual and \$75,000 against an entity for violations occurring after March 3, 2009, for each violation of the securities laws, or (b) the gross amount of pecuniary gain to an individual respondent as a result of the violation.

³⁹⁵ Commission v. Palmisano, 135 F.3d 860, 866 (2nd Cir. 1998); Commission v. K.W. Brown, 555 F. Supp. 2d 1275, 1314 (S.D. Fla. 2007); Commission v. Tanner, 02 Civ. 0306, 2003 WL 21523978 at *2 (S.D.N.Y. July 3, 2003); Commission v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 17 (D.D.C. 1998); Commission v. Moran, 944 F. Supp. 286, 296 (S.D.N.Y. 1996).

³⁹⁶ 1990 WL 256464 *20, 1990 U.S.C.C.A.N. 1379 *1384 (Leg. Hist.), H.R. Rep. 101-616, H.R. Rep. No. 616, 101st Cong., 2nd Sess. 1990.

³⁹⁷ Statement of the Securities and Exchange Commission Concerning Financial Penalties, Rel. No. 2006-4 (Jan. 4, 2006).

The “Second Tier” applies where a violation involved “fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.”³⁹⁸ Under this tier, the Law Judge may impose a penalty of up to (a) \$65,00 against an individual and \$325,000 against an entity for violations occurring between February 2005 and March 3, 2009, or \$75,000 against an individual and \$375,000 against an entity for violations occurring after March 3, 2009, for each violation of the securities laws, or (b) the gross amount of pecuniary gain to a respondent as a result of the violation.

The “Third Tier” applies when the requirements of a Second Tier penalty are present and the violation “directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.”³⁹⁹ Under this tier, the Law Judge may impose a penalty of up to (a) \$130,000 against an individual and \$650,000 against an entity for violations occurring between February 2005 and March 3, 2009, or \$150,000 against an individual and \$725,000 against an entity for violations occurring after March 3, 2009, for each violation of the securities laws, or (b) the gross amount of pecuniary gain to a respondent as a result of the violation.⁴⁰⁰

The Division submits that, based on the fraudulent conduct at issue in this case, the Law Judge should impose a Second-Tier penalty. Here, the underlying violations involve fraud, deceit, and deliberate disregard of a regulatory requirement. The Respondents knowingly distributed false advertisements even after both Ashland and the ZPR advised them of the deficiencies in their advertisements. They showed utter disregard for the GIPS ethical standards they claimed with

³⁹⁸ 15 U.S.C. § 77t(d).

³⁹⁹ *Id.*

⁴⁰⁰ The figures for all three tiers come from the Federal Civil Penalties Inflation Adjustment Act of 1990, which adjusted the potential penalty amounts to account for inflation based on violation dates. 17 C.F.R. §§ 201.1001-1004. The figures here were updated in February 2009, in the middle of the fraudulent conduct.

which they claimed ZPR complied, and used their false claims of compliance to lure investors. They showed utter disregard for the truth and the anti-fraud provisions of the federal securities laws when they falsely claimed there was no Commission investigation, despite being actively engaged in the investigation when they made these false statements.

The Division seeks a one-time second-tier penalty of \$375,000 against ZPR. Since the majority of the unlawful conduct happened after March 3, 2009, the Court should impose the penalty at this rate rather than the rate applicable to violations prior to March 3, 2009. As to Zavanelli, the Division seeks a second-tier penalty for each of the eleven violations at issue in this case. Since three occurred prior to March 3, 2009 ($\$65,000 \times 3$), and eight occurred after March 3, 2009 ($\$75,000 \times 8$), this amount equals \$795,000.

The penalties the Division is seeking are reasonable given the facts and circumstances of this case. A one-time penalty is appropriate against ZPR based on its conduct, while a penalty for each violation is appropriate against Zavanelli because he engaged in the conduct, owned the firm, approved the advertisements, operated ZPR as his alter ego, and was, as Bauchle testified, the “boss man” who made all the decisions. He presented no evidence of any inability to pay. The Division could seek a much higher civil penalty if we sought a penalty for each instance of violative conduct, *e.g.*, for each of the approximately twenty magazine advertisements ZPR, at Zavanelli’s instruction, published between 2008 and 2011.⁴⁰¹ Instead, we seek a penalty based on only those six magazine advertisements alleged in the OIP. We could seek violations for each of the monthly newsletters Zavanelli wrote and distributed that falsely claimed GIPS compliance. However, we only seek a penalty based on two of them. If we included all of the violative

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advertisements, this would result in a much higher penalty calculation than the method and amount we propose.

D. The Law Judge Should Censure ZPR

The Law Judge should censure ZPR pursuant to Section 203 of the Advisers Act. Censure is the minimum administrative sanction available to the Commission in administrative actions against regulated persons or entities.⁴⁰² The Commission may censure individuals and entities in the securities industry if it finds securities violations (1) on the record, (2) after notice and opportunity for hearing, and (3) if the censure is in the public interest.⁴⁰³

The Commission is authorized to censure entities and individuals for violations of securities laws when it finds those entities or individuals have willfully violated or aided, abetted, counseled, commanded, induced, or procured the violation of the securities laws. “Willfully” in the context of Commission enforcement actions means “intentionally committing the act which constitutes the violation.”⁴⁰⁴ This does not require a finding that ZPR had knowledge of the rule or regulation violated.⁴⁰⁵

As set forth above, ZPR engaged in a series of false statements and omissions to potential investors in violation of the Advisers Act, and the public interest factors set forth in Steadman are met. Accordingly, the Law Judge should censure ZPR for its violations.

⁴⁰² Teicher v. Commission, 177 F.3d 1016, 1018 (DC Cir. 1999) (stating that sanctions for securities law violations range “... from censure to an outright ban...”). Black’s Law Dictionary defines censure as “an official reprimand.” Black’s Law Dictionary 224 (6th ed. 1990).

⁴⁰³ Exchange Act § 15(b)(4).

⁴⁰⁴ Wonsover v. Commission, 205 F.3d 408, 414 (D.C. Cir. 2000).

⁴⁰⁵ *Id.*

XI. CONCLUSION

For all the forgoing reasons, the Division submits that based on the evidence presented at the hearing in this matter, the Law Judge should find that Zavanelli and ZPR violated Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act or, in the alternative as to Zavanelli, that he aided, abetted and caused ZPR's violations of these provisions of the Advisers Act. Furthermore, the Law Judge should impose the sanctions we request.

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Respectfully submitted,



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