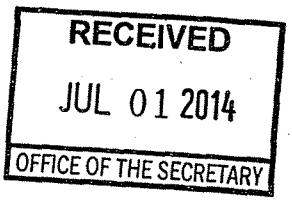
UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION



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In the Matter of	:	
	:	**Administrative Proceeding**
ZPR INVESTMENT MANAGMENT, INC., and MAX E. ZAVANELLI	:	**File No. 3-15263**
	:	
Respondents.	:	

RESPONDENTS, ZPR INVESTMENT MANAGEMENT, INC. AND MAX E. ZAVANELLI PETITION FOR REVIEW

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RESPONDENTS' PETITION FOR REVIEW[1]

Pursuant to Rules 410 and 411(b)(2)(ii) of the Securities and Exchange Commission's Rules of Practice, Respondents, ZPR INVESTMENT MANAGEMENT, INC. ("ZPR") and MAX E. ZAVANELLI ("Zavanelli") (collectively referred to as the "Respondents"), hereby petition the Securities and Exchange Commission ("Commission" or "SEC") to review the Initial Decision ("Decision") rendered in this matter on May 27, 2014.

I. INTRODUCTION

1. The Commission should review the Decision because it embodies:

(i) findings or conclusions of material facts that are clearly erroneous;

(ii) conclusions of law that are erroneous; and

(iii) a decision of law or policy that is important in the regulation of investment advisers.

2. The Decision had findings that six (6) magazine advertisements; two (2) investment newsletters; and two (2) *Morningstar* reports spanning a period from October of 2008 through May of 2011 were misleading, which resulted in eleven (11) separate violations. However, the Decision also found that

(i) Max Zavanelli has been rated by *Morningstar* with five stars (the highest rating) for the past ten (10) years. *See* RX-5, 6, 7, 15, 17, and 19.

(ii) With respect to the period, prior to April 9, 2008, the Administrative Law Judge ("ALJ") reviewed the Respondents' "conduct for various purposes but I have not found any violations based on such conduct." Decision, page 60.

[1] Citations to the transcript of the hearing are noted as "TR-___". Citations to Exhibits offered by the Commission and the Respondents are noted as "DX-__" and "RX-__", respectively

(iii) "Zavanelli has had no disciplinary issues with the Commission since the 1987 order." Decision, page 4.

(iv) ZPRIM has been a GIPS[2] compliant firm since 2006. Decision, page 11. ZPRIM sent the GIPS compliant presentations to its clients at least once every 12 months and the GIPS compliant presentations were also given to prospective clients. Decision, page 9, footnote 6. The GIPS compliant presentations were available on the ZPRIM's website and the returns were updated quarterly and posted on its website. ZPRIM maintained annualized performance returns that included one, three and five year periods, which were also posted on its website. The website also provided bar charts showing the performance of the firm's composites as compared to their bench marks. Decision, page 12.

(v) No evidence was introduced that any of the performance numbers described in paragraph 3 were inaccurate or misleading. Decision, page 20. To the contrary, the SEC examiner, Jean Cabot ("Cabot"), testified that all statements she reviewed regarding the firm's performance were accurate including the performance information on the 10 advertisements and reports. TR-682. This was also confirmed by the firm's GIPS verifier, Nikola Feliz ("Feliz"), who testified as an expert witness on GIPS on behalf of the Commission. TR-1041. "The OIP does not allege that the [ZPRIM] performance returns were misleading." Decision, page 48.

(vi) The firm's performance has been consistently verified as being GIPS compliant from 2000 to 2011. Decision, page 20.

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[2] The Global Investment Performance Standards ("GIPS") are a set of voluntary standards for performance presentation of investment results that were created and are administered by the CFA Institute. *See* RX-3. The goal of GIPS is to achieve full disclosure and fair representation of investment performance by firms claiming compliance with GIPS. *Id* at page 2, ¶ D.10.g.

(vii) Each of the six (6) magazine advertisements identified in the OIP directed the reader to the firm's website, www.zprim.cm, which contained all of the investment performance information described in paragraph 3. These magazine advertisements also stated that "complete description of the policies and procedures for this composite and a list and description of all firm composites are available upon request." *See* RX-3, 4, and 5.

(viii) ZPRIM acted only negligently with respect to certain *Morningstar* reports. Decision, page 55.

(ix) There was a finding that Zavanelli "genuinely believed" the ZPRIM investment newsletters were not advertisements. Decision, page 54.

(x) Mark Zavanelli "credibly testified that ZPRIM is making, and has made, considerable progress in improving its compliance practices" and the ALJ stated that "overall I find that ZPRIM has provided sincere assurances against future violations and recognized the wrongful nature of its conduct." Decision, page 61.

(xi) No investors were harmed by any of the advertisements or reports at issue. Decision, page 62.

(xii) "[T]he fall 2008 advertisements failed to generate any new ZPRIM clients, and Max Zavanelli testified that the advertisements were a "disaster". Decision, page 27.

(xiii) The only aspect of the six (6) magazine advertisements raised in the OIP that rendered them as a non-compliant was a statement – in small type contained in a footnote – that ZPRIM was GIPS compliant. *See* RX-5, 6, 7, 13, 15, and 17. Because these ads did not include performance data as required by the GIPS Advertising Guidelines and the footnote included a claim of GIPS compliance, the advertisements

were deemed to be misleading. *See* OIP. No allegations or findings were made that any of the performance data reported in these advertisements was incorrect, and therefore, if the advertisements had merely omitted the footnote sentence that made a claim of GIPS compliance, no violations would have resulted.

3. Notwithstanding these findings and circumstances regarding the Respondents' conduct, second-tier penalties were assessed totaling $910,000 and Max Zavanelli was permanently barred from associating with any Investment Adviser or other SEC regulated entity. In the case of Max Zavanelli and if the Decision is upheld, a man stands to lose his life's work and reputation over a claim that his firm was GIPS compliant, a statement that was completely accurate.

II. THE ORDER INSTITUTING PROCEEDINGS

4. The Order Instituting Proceeding ("OIP) was filed on April 4, 2013. The gravamen of the OIP related to magazine advertisements that were allegedly misleading on two grounds. First, the failure of the firm to include certain performance periods as required by the Advertising Guidelines for Global Investment Performance Standards ("GIPS"). Second, ZPRIM's failure to include period to date returns in three (3) of the advertisements, which would have shown that in 2008 (when the advertisements were published), the firm was underperforming its benchmark, the Russell 2000 Index. A second area within the OIP involved two (2) investment newsletters published in 2009 by the firm, which claimed GIPS compliance but failed to follow the GIPS Advertising Guidelines. A third area within the OIP involved three (3) advertisements placed by ZPRIM in 2011 that reprinted information from another magazine but failed to include three and five year annualized performance returns. Finally, the OIP alleged that information regarding its verifier, Ashland Partners & Company, LLP ("Ashland"), and the

use of the world "audit" that appeared in a *Morningstar* report dated September 30, 2010, was misleading. In addition, the OIP alleged that the firm failed to disclose the pending SEC investigation in the same report and in another *Morningstar* report dated March 31, 2011.

III. BASIS FOR REVIEW

A. ERRONEOUS FINDINGS OF FACT

I. ZPRIM's composites have had good years and some bad years and performance in parts of 2008 and 2009 was particularly poor. Decision, page 6.

5. The work papers of Ashland regarding GIPS verification of ZPRIM were admitted into evidence. An entry made by Ashland on March 22, 2006, stated:

> Over the last 5 years they have crushed their benchmark.

See DX-40, 22.

6. A quarterly performance sheet for the ZPRIM Small Cap Value ("SCV") composite with quarterly and annual performance returns was admitted into evidence as DX-56. In 2009, the SCV composite was down (13.23%) in the first quarter but had positive returns for each remaining quarter of 2009 with an annual return of 43.77%. In 2008, the composite had negative returns in the first, third and fourth quarters and a negative annual return of (40.11%). For 2001 through 2007, the annual performance returns ranged from a high of 55.36% to a low of 3.35%. Since 2001 through 2009, the composite has realized a positive annual return of 17.28%. Thus, the only "bad" year(s) was in 2008 when the Dow Jones Industrial ("Dow") fell from 14,000 to 6,700.

7. Exhibit RX-8 was admitted into evidence which showed the returns for the ZPRIM International Global Equity ("IBE") composite. In 2009, this composite was also down in the first quarter by 8.68%, but like the SCV composite, had positive returns for each

remaining quarter of 2009 and had an annual return in 2009 of 69.44%. In 2008, the IBE composite had negative returns in each quarter and had a negative annual return of (50.85%). Between 2001 and 2007, the annual performance returns for this composite ranged from a high of 49.37% to a low of 9.28%. Since 2001 through 2009, this composite has realized a positive annual return of 19.19%. Thus and like the SCV composite, the only bad year for the IBE composite occurred in 2008.

II. The finding made by the ALJ that "Firms that do not meet all of GIPS' requirements cannot represent that they are in compliance with GIPS" is clearly erroneous. Decision, pages 8 and 9.

8. The Decision makes reference to the testimony of Feliz who stated that "a firm claiming compliance within the advertisement must follow all of the guidelines within the [GIPS] advertising guidelines. TR-938. Feliz also testified as follows:

Question: If you meet every single – if you meet item 5 [of the GIPS Advertising Guidelines] but you don't meet the other ones, is that complying with the [GIPS] Advertising Guidelines.

Answer: No.

This testimony, therefore, relates only to the GIPS Advertising Guidelines requirements and was unrelated to a firm's overall claim of GIPS compliance.

9. However and overlooked by the Decision, the GIPS standards embrace an Error Correction Policy that is designed to allow firms to correct compliance errors that are made without jeopardizing an overall claim of GIPS compliance. *See* RX-40; RX-41. Feliz testified that if a firm made a mistake in an advertisement and provided GIPS compliant supplemental information to prospective clients that corrected the mistake, GIPS advertising requirements would be satisfied. TR-1064. She also testified that when a firm takes corrective action to address mistakes that appear in its advertisements, the prior mistakes or errors made do not

jeopardize an overall clam of GIPS compliance by the firm. TR-1029, TR-1069. Thus, the GIPS standards themselves allow for mistakes and errors provided that corrective action is taken, which the Decision overlooked and did not consider. This position is also consistent with information provided by the GIPS Helpdesk that "typically, the identification of an error does not require the firm from ceasing its claim of compliance with the [GIPS] Standards." *See* RX-34.

III. The ALJ's comment that "it is unlikely that Ashland would have advised ZPRIM how to craft the footnote other than to direct ZPRIM to the standardized language found in the GIPS guidelines," Decision, page 14, footnote 11, is not supported by the evidence.

10. Bauchle testified that Ashland had assisted ZPRIM in creating an advertisement template. TR-187. Max Zavanelli also testified that Ashland prepared footnote disclosures that were part of the ZPRIM advertisement template. TR-1397. This testimony was corroborated by e-mails that were exchanged between Ashland and Bauchle in April 2008, through which Ashland suggested that additional changes to footnote disclosure language be made by ZPRIM. *See* DX-64; RX-47; and DX-21, pages 00005-00011 and 00013-00021.

IV. The verifier for Ashland, Nikola Feliz ("Feliz"), testified during the SEC investigation that she had no issues with ZPRIM's advertisements or marketing materials other than a December 2009 newsletter. TR-1026-27; Decision, page 15.

11. During the final hearing, Feliz testified on behalf of the Commission that she recalled a telephone conference she and Carrie Hoxmeier, another Ashland representative, had with Ted Bauchle regarding a January 2008 *Kiplinger* magazine advertisement that was not GIPS compliant. TR-927, 928. She also testified that Bauchle stated during this conversation that ZPRIM did not intend to place any more advertisements. TR-936. Bauchle, however, had previously testified that no representative from Ashland had ever called him to express concerns

about GIPS compliance issues with ZPRIM advertisements. TR-291. In the Decision, the ALJ resolved the conflicting testimony by finding that, "She [Feliz] convincingly explained that she had not reviewed her notes on ZPRIM prior to her investigative testimony because she had no prior notice of what the testimony would be about, and that she only remembered the telephone call with Hoxmeier and Bauchle when her memory was refreshed by reviewing the advertisements and her notes." Decision, page 15, footnote 12. The testimony of Feliz during the investigation was admitted into evidence as DX-88. Contrary to the findings in the Decision, Feliz testified she had reviewed her notes before testifying in the investigation. See DX-88, page 25.

Question: Okay before you came to testimony today did you review any of the history with regard to ZPR?

Answer: I looked over the history, yes.

12. Feliz also testified during the investigation that she reviewed the January 2008 Kiplinger advertisement but did not recall ever having reviewed it before. DX-88, page 146. Further, there were no follow-up e-mails or other correspondence that Feliz or Hoxmeier sent to Bauchle after their "conversation." TR-1020. As a result of this testimony, there should be no finding that Feliz's testimony regarding an alleged telephone call she had with Bauchle about the January 2008 ZPRIM advertisement was credible.

V. Evidence was presented by Cabot and Feliz that ZPRIM advertisements did not clearly disclose how an investor could receive a GIPS compliant presentation.

13. Under the GIPS Advertising Guidelines, the advertisements must disclose "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." *See* RX-3, page 34 (item 2 of the GIPS Advertising Guidelines requirements). The Decision found the interpretation of this

requirement offered by Cabot and Feliz that disclosure of both a GIPS presentation and a list and description of the firm's composites was required to be in advertisements. The plain language contained in the advertisements clearly told how one could obtain a list and description of the composites but failed to disclose how one could obtain a GIPS compliant presentation. The interpretation followed in the Decision gave no effect to the term "or". The definition of "and/or" means "used to join terms when either one or the other or both is indicated." *See* Merriam Webster at merriam-webster.com. If this definition is followed, the advertisements in question were GIPS compliant regarding this requirement. Additionally, this was not an issue charged in the OIP and therefore, should not be considered.

VI. The ALJ erroneously held that "I credit the testimony of Cabot and Feliz, and conclude that Max Zavanelli directed Bauchle to stop sending advertising to Ashland and to provide Ashland a plausible, but false explanation." Decision, page 17, footnote 14.

14. In making this finding, the Decision rejected the testimony of Zavanelli and Bauchle and accepted unsupported testimony of Cabot and Feliz. There is simply no evidence to support finding that ZPRIM intentionally failed to send advertisements to Ashland. First, the testimony of Bauchle during the investigation and during the hearing provides no support for this finding. Bauchle never testified that Max Zavanelli instructed him not to send advertisements to Ashland. Second, there is no testimony from Max Zavanelli that supports this finding. His investigative testimony reflects a clear position that advertising by ZPRIM was not given to Ashland because he did not believe ZPRIM needed to. DX-89, p. 49. Cabot initially testified that Bauchle told her that Max Zavanelli instructed him not to send advertisements to Ashland when Bauchle was being prepped to testify for the Commission just before the commencement of the hearing. *See* TR page 518, line 20. There is no testimony from Bauchle, however, that corroborates Cabot's testimony. Cabot was also impeached by the Respondents' counsel on this

point and she changed her testimony. TR-521. At the hearing, Bauchle stated that he previously testified before the Commission that he had never sent any advertisements to Ashland. TR-286. Bauchle then testified after reviewing Exhibit DX-55 that he had sent one (1) advertisement to Ashland, in January 2008 (TR-288, 289), which Cabot also claimed to be consistent with statements Bauchle made to her during the SEC examination and during Bauchle's witness preparation by the SEC. TR-521. Based upon this evidence, there was no testimony that supported a finding that Mr. Zavanelli told Bauchle to stop sending advertisements to Ashland. Cabot's testimony on this point, which she later changed, has no credibility. If, in fact, Bauchle told this to Cabot during the SEC investigation or during Bauchle's witness prep, then why didn't the Commission have Bauchle testify to this important conversation rather than have Cabot testify regarding a hearsay statement? The reason is clear. The conversation never happened. In support, is the testimony of Bauchle at the hearing, TR-266:

Question: At any time in this before you left or were asked to leave in 2013 over this 18, 19-year period, do you recall Max Zavanelli ever asking you to do something in your mind that was wrong?

Answer: That was wrong?

Question: Wrong.

Answer: No.

15. The ALJ's findings on this issue also ignored other documentary evidence and testimony that proved Ashland never requested ZPRIM to send it advertisements to review. *See e.g.* RX-13 and testimony of Ruth Ann Fay at TR-1257, 1267, 1272, and 1274. Feliz also testified that to her knowledge no one at Ashland ever instructed Bauchle, its primary contact, that ZPRIM should provide advertisements to Ashland (TR-1041) but acknowledged that Bauchle sent ZPRIM marketing materials for each verification period (TR-1019).

VII. The ALJ's finding that "I accord no credit . . . to his [Max Zavanelli] testimony that Bauchle never told him about the [Ashland] letter" is not supported by any evidence in the record. Decision, page 19, footnote 16.

16. In March or April 2010, Feliz and Toby Cochrane, the Ashland partner assigned to ZPRIM, had a telephone call with Max Zavanelli to discuss the applicability of GIPS Advertising Guidelines to a monthly investment newsletter that ZPRIM prepared. TR-993, 994. After this discussion, Feliz sent a letter to Bauchle that described two options she felt ZPRIM could use to comply with GIPS for the newsletter. DX-52. One of the options provided was that ZPRIM not make a claim of GIPS compliance in the investment letter. Max Zavanelli, however, testified that the first time he ever saw the Feliz letter was during his testimony before the Commission in June 2011. DX-89, page 122. There was no evidence that rebutted this position. Although the letter was addressed to Bauchle, there was no testimony provided by him that he provided the letter to Max Zavanelli. In addition, Feliz testified that she did not know if Max Zavanelli ever received her letter. TR-1087. If he had timely received the Feliz letter, Max Zavanelli testified that he would have elected to remove any references to GIPS in the investment newsletter. TR-1458. This action, had it been taken, would have satisfied Ashland's concerns.

VIII. Alpha verified ZPRIM's GIPS compliance for the period ended December 31, 2011, but no evidence was introduced that Alpha verified ZPRIM's GIPS compliance for 2012. RX-22, Decision, page 20.

17. RX-29 that was introduced into evidence represented pages from the current ZPRIM website. Page 2 of its exhibit plainly stated the following:

> ZPR Investment Management, Inc.'s compliance with the Global Investment Performance Standards (GIPS) has been verified firm wide from December 31, 2000 through December 31, 2012. [Emphasis Supplied]

18. In addition, Mark Zavanelli who has served as the President and Chief Compliance Offer for ZPRIM since October 2011, testified about the GIPS disclosures that appeared in this exhibit. TR-1756-1559.

IX. The Decision omitted testimony that explained why Max Zavanelli was defensive when he spoke with Cabot during the SEC's onsite examination of ZPRIM. Decision, pages 20 and 21.

19. Cabot testified that when she discussed deficiencies about ZPRIM's business that the SEC examination staff identified, Max Zavanelli was defensive because as she stated "it is his business and he was very proud of his business." TR-490.

X. The Decision erroneously suggests that ZPRIM withheld the SEC deficiency letter dated January 28, 2010, from Ashland. Decision, page 21, footnote 19.

20. The evidence introduced during the final hearing clearly demonstrated that ZPRIM made Ashland aware of the SEC onsite examination that was conducted in February 2009. *See* RX-13.

21. The evidence also demonstrated that Ashland performed GIPS verification services for ZPRIM between December 31, 2000, and December 31, 2009 and that Ashland did not perform any GIPS verification services for ZPRIM after December 31, 2009. *See* DX-36.

22. The ZPRIM representation letter dated March 23, 2006, stated that:

"We [ZPRIM] have made available to you [Ashland] all findings and related correspondence with Regulatory Agencies within the period of verification." DX-40, pages 7, 8.

23. However, since Ashland provided no verification services for ZPRIM after December 31, 2009, there was no need or obligation for ZPRIM to provide Ashland with the SEC deficiency letter, which was not issued until January 2010. DX-77.

XI. Decision erroneously found that ZPRIM did not correct deficiencies in advertisements it placed after the date of its response to the SEC deficiency letter. Decision, page 22.

24. Notwithstanding Cabot's testimony to the contrary (TR-491, 492), ZPRIM removed the world "audit" from advertisements it placed after April 2008. *See* DX-21.

25. Advertisements that were introduced into evidence and placed by ZPRIM after February 2010, the date of its response to the SEC deficiency letter (DX-78), were not required to include period to date performance returns under the 2010 GIPS Advertising Guidelines. *See* RX-4, page 30, ¶5.a.

XII. The ZPRIM response to the SEC examination deficiency letter stated the firm would make corrections in the advertisements but the Decision found the advertisements after the response failed to include performance returns with period-to-date numbers and ZPRIM also claimed that its returns had been audited instead of verified. Decision, page 22.

26. The word "audited" never appeared in a magazine advertisement after the firm responded to the deficiency letter. See DX-21 and DX-77. Also, during the hearing, Bauchle and Cabot were shown copies of ZPRIM advertisements that were dated after the SEC deficiency letter response and they both agreed the word "audited" had been removed from these advertisements. In 2010, the GIPS Advertising Guidelines were modified to eliminate the requirement to include period-to-date performance in advertisements. See RX-4, page 30, ¶5.a. Zavanelli testified that in 2009 he followed the new GIPS guideline prior to its effective date as a "best practices". Decision, pages 29, 30. However, the Decision gave no credence to this testimony since the new Guidelines were not implemented until March 29, 2010, "well after the November and December 2009 advertisements...." The Decision states, at page 30, footnote 26, that "Although it is theoretically possible that Max Zavanelli could have been aware in 2009 of the planned 2010 GIPS Guidelines' option to drop period-to-date returns, there is no record

evidence explaining how he gained such awareness...." Admitted into evidence, however, was the ZPRIM newsletter for December 2009. *See* Exhibit RX-24. The newsletter reported that there were changes to GIPS standards that would be taking place in 2010 and the firm was working with its verifier (Ashland) to implement the new changes. The newsletter stated:

> There are new Global Investment Performance Standards that have been proposed for 2010 and our auditors/verifiers have been trying to get us ready. The investment report you are reading is not GIPS compliant.

27. Based upon this evidence, the Zavanelli testimony is credible that the firm was adopting "best practices" by following the new GIPS Advertising Guidelines before they went into effect.

XIII. ZPRIM in the response to the SEC deficiency letter stated "[W]e wonder why Ashland Partners did not mention this during the verification process." The Decision states on page 22, footnote 20, that "This comment was at best disingenuous; Ashland had alerted ZPRIM in November 2008 to ZPRIM's failure to include a disclosure of currency and a description of the composite's benchmark."

28. When the SEC during the examination raised issues regarding the advertisements, Ruth Ann Fay, the firm's chief compliance officer at that time, sent the following e-mail to Ashland on February 17, 2009, which was admitted into evidence as RX-13:

> "They [SEC] also said we should be sending you [Ashland] our ads and brochures. I wonder if they are confusing your two functions? Or are they correct? We had used "audit" in one of our earlier ads. Ashland had caught that and we started using "verify". They found the old ad though."

29. Bauchle was not involved in responding to the SEC deficiency letter but was primarily responsible for GIPS compliance including being the contact person with Ashland. TR-296, 297. Ruth Ann Fay ("Fay") was the person responsible for responding to the deficiency letter. DX-78. It is clear that she had not been told by Bauchle about the November 2008 email

from Ashland which explains her response to the SEC and her questions to Ashland in the email. RX-13.

XIV. The format used to place advertisements by ZPRIM between October and December 2008 was not changed to avoid publicizing poor returns. Decision, page 24.

30. Advertisements placed by ZPRIM in the 2008 October, November and December issues of *SmartMoney* magazine did not include performance results required by the GIPS Advertising Guidelines. *See* RX-5, 6 and 7. However, all performance results that were required by the GIPS Advertising Guidelines were disclosed by ZPRIM on its website and made available to prospective clients through direct mailings between October and December 2008 when the *SmartMoney* advertisements at issue were published. Those documents all showed that ZPRIM SCV composite was under performing its benchmark. RX-8 through RX-11.

31. In addition, the evidence demonstrated that Bauchle and others, that did not include Max Zavanelli, created the format used to place the *SmartMoney* advertisements (RX-46) and Max Zavanelli was not provided with copies of these advertisements prior to publication. TR-1415 through 1417. In addition, the format used for these *SmartMoney* advertisements were totally inconsistent with specific instructions Max Zavanelli had given to Bauchle, which was to follow the previous format that ZPRIM had used to place its previous 2008 April advertisement in *SmartMoney*. TR-1413, 1414.

32. In view of the weight of contradictory evidence presented, the Decision erroneously found Bauchle's testimony that the ZPRIM advertisement format in the fall of 2008 was changed to avoid showing poor performance to be credible.

XV. Testimony of Max Zavanelli relating to the October, November and December *SmartMoney* advertisements was not contradictory. Decision, pages 25, 26.

33. Max Zavanelli's testimony that he was not provided with copies of and therefore, did not review the 2008 October, November and December *SmartMoney* Advertisements before they were published, was consistent. TR-1415, 1416.

XVI. The Decision fails to mention that the April 2009 Investment Newsletter did not raise concerns for Ashland. Decision, page 30.

34. ZPRIM posted its monthly investment newsletter on its website, which was reviewed by Ashland as a part of its GIPS verification process. DX-40, page 9; TR-1080, 1081.

35. Feliz testified that prior to 2010 there were no GIPS compliant issues with respect to any ZPRIM investment newsletters. TR-1029.

36. In addition, the performance results for one, three and five year annualized returns for ZPRIM's composites as required by GIPS were also posted its website and made available to prospective clients through direct mailings. RX-8 through RX-11.

XVII. The Decision erroneously found that the December 2009 Investment Newsletter made a claim of GIPS compliance. Decision, page 31.

37. Feliz testified that the GIPS Advertising Guidelines are not applicable to advertisements that do not contain a claim of GIPS compliance by a firm. TR-1081.

38. The December 2009 ZPRIM investment newsletter contained an article about GIPS and specifically stated that the investment report itself was not GIPS compliant. RX-4, page 4. Feliz testified that an article about GIPS does not trigger the applicability of the GIPS Advertising Guidelines. TR-1081; 1083.

39. Accordingly, ZPRIM was not required to follow the GIPS Advertising Guidelines with respect to the December 2009 investment newsletter.

XVIII. The Decision erroneously determined that testimony provided by Max Zavanelli about *Morningstar* reports was not credible. Decision, page 32.

40. ZPRIM began providing data about its investment performance results to *Pensions and Investments* in 1991 and the later to *Morningstar* that forwarded it to *Pensions and Investments.* TR-1463, 1464.

41. *Pensions and Investments* utilized data it received to rank money managers and ZPRIM utilized the published results in certain advertisements it placed. *See e.g.* RX-17.

42. Max Zavanelli's unrebutted testimony, which was also corroborated by Bauchle demonstrated that Bauchle was solely responsible for providing data to *Morningstar*; that Max Zavanelli did not have a login password to the *Morningstar* database; and that Max Zavanelli never accessed the *Morningstar* data base. TR-269, 270, 277, 1466, 1581.

43. Max Zavanelli also truthfully testified that he did not use *Morningstar* to research other companies and had not read a complete *Morningstar* report until 2011. TR-1581, 1582, 1585, 1586.

44. The evidence further showed that he was not aware of the specific information Bauchle was providing to *Morningstar* until at least May 12, 2011 and clearly after the September 30, 2010 and March 31, 2011, *Morningstar* reports raised in the OIP were published. DX-157, RX-25, 26.

45. Max Zavanelli also testified that the first time he learned the *Morningstar* reports had a "pending SEC investigation box," was when ZPRIM received a Wells notice. TR-1467. This testimony was likewise unrebutted and should have been viewed by the ALJ as credible.

XIX. Decision erroneously concluded the *Morningstar* website did not require that charges be filed before disclosure of an SEC investigation was required. Decision, page 34.

46. RX-38 was admitted into evidence and represented screen shots from the *Morningstar Institutional Data Manager* through which Bauchle would upload information about ZPRIM.

47. Pages 3 and 4 of RX-38 contain the phrase "Pending SEC Investigation Charge" and "Effective Date" which prompts the firm who is providing data to *Morningstar* to answer "yes" or "no". If "yes" is answered to a "Pending SEC Investigation Charge," then the date of the charge ("Effective Date") must be provided.

48. Since no formal "charges" were filed by the SEC before the date of the OIP, April 14, 2013, ZPRIM understandably did not answer "yes" and report a "Pending SEC Investigation Charge" in *Morningstar* reports dated September 30, 2010 and March 31, 2011. RX-25, 26.

49. Thus, Max Zavanelli's testimony about how ZPRIM responded to the *Morningstar* disclosure item concerning a "Pending SEC Investigation" was credible and consistent with the very requirements of *Morningstar* itself. TR-1714, 1715; RX-38.

B. ERRONEOUS CONCLUSIONS OF LAW

I. Misrepresentations: The Decision erroneously concludes that while all of the information in the magazine advertisements and newsletters regarding performance was accurate and complied with the GIPS standards regarding performance, the advertisements were misleading because, in a footnote, the firm said it was GIPS compliant, which required the firm to follow the GIPS Advertising Guidelines. Decision, pages 47-49.

50. The evidence was uncontradicted that ZPRIM was GIPS compliant from December 3, 2000 to December 31, 2012 and was verified by GIPS compliance firms. Notwithstanding this evidence, the Decision concludes that failing to follow the GIPS Advertising Guidelines regarding performance periods somehow renders the advertisements

misleading by claiming the firm was GIPS compliant. The statement in the footnote should not be viewed in isolation. Whether a misrepresentation is material is satisfied when there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available." *See Basic. Inc. v. Levinson,* 485 U.S. 224, 236, 108 S.Ct. 978, 985, 99 L.Ed.2d 194, 211 (1988); *Matrixx Initiatives, Inc. v. Siracusano,* 131 S.Ct. 1309, 179 L.Ed.2d 398 (2011). The evidence demonstrated and the Decision concluded that if someone responded to the advertisement before becoming a client they would receive a GIPS compliant presentation. Decision, page 9, footnote 6. In addition, the advertisements directed the reader to the firm's website which also contained the GIPS compliant presentations. Decision, page 10. The website also contained ZPRIM annualized returns that included one, three and five year periods. *Id.* The website also provided bar charts showing the performance of the firm's composites as compared to their bench marks. *Id.* As noted earlier, the Decision found that all of this performance information was completely accurate. The evidence also clearly demonstrated that as a part of its routine business practices, ZPRIM sent prospective clients performance results for its composites and other marketing information about the firm. RX-16, 18, and 20. During 2008, this information included performance results that showed ZPRIM's SCV composite was under performing its benchmark, the Russell 2000 and this performance information was also disclosed on the ZPRIM website. *See* RX-8 through RX-11. When this "total mix" of information is then taken into consideration, it is impossible to conclude that the advertisements were misleading or misrepresented the performance of the firm. For example, it has been held that accounting irregularities that related to a small portion of the overall financial picture were immaterial as a matter of law. *See Schuster v. Symmetricon, Inc.,* 2000 WL 33115909 [2000-2001 Transfer

Binder] Fed.Sec.L.Rep (CCH) ¶91,206 (N.D. Cal. 2000) and *Hutchison v. Deutsche Bank Securities, 647 F.3d 479 (2d Cir. 2011).* It would also be impossible for a prospective client to conclude the firm was not GIPS compliant since it was, in fact, GIPS compliant which was confirmed by the verification firms that reviewed the performance of ZPRIM during the relevant period of time. RX-14, 22 and 29. As a result, the footnote in the advertisements when coupled with the "total mix" of information was not misleading.

II. Scienter: Magazine Advertisements and Newsletters. The Decision erroneously concludes the Respondents acted with scienter when the GIPS Advertising Guidelines were not followed.

51. It should be noted at the outset that if the advertisements and newsletters raised in the OIP that failed to follow the GIPS Advertising Guidelines were not misleading when viewed with the "total mix" of information that was being provided, there would be no violation of the Adviser's Act even if the Respondents acted with scienter since the information was not material. Assuming *arguendo* that the failure to follow the voluntary GIPS Advertising Guideline is material, the Respondents did not act with scienter. The Eleventh Circuit, which would have jurisdiction of this matter in the event of an appeal, requires that scienter be proven by a "showing of either an 'intent to deceive, manipulate, or defraud,' or 'severe recklessness.' *See Mizzaro v. Home Depot, Inc.,* 544 F.3d 1230, 1238 (11th Cir. 2008) (quoting *Bryant v. Avado Brands, Inc.,* 1877 F.3d 1271, 1284 (11th Cir. 1999). If the Respondents intended to deceive, manipulate, or defraud a prospective client through the advertisements, they would not have directed the reader to a plethora of information that provided full and fair disclosure of all material facts in making the decision to be a customer of the firm. This information clearly showed that the firm in 2008 was underperforming its benchmarks. *See* RX-8 through 11. At this time, the Russell 2000 and S&P 500 benchmarks were in negative territory and so were the

firm's investment composites. The inquiry then turns to the issue of "severe recklessness," which was defined by the Eleventh Circuit in *Bryant* as follows:

> Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it. [Emphasis Supplied]

Id. (quoting *Bryant,* 187 F.3d at 1282 n. 18 (quotation marks omitted by the Mizzaro court).

52. When the conduct of the Respondents is viewed under this standard, it is clear that there was no danger that a prospective customer was being misled since a flood of additional information was being provided by the firm regarding its performance. The advertisements, even if viewed in isolation, would not be considered "highly unreasonable misrepresentations" since all of the information in the body of the advertisement was accurate. At best, the conduct of the Respondents would be simple or inexcusable negligence in failing to follow the GIPS Advertising Guidelines but does not rise to the level of severe recklessness. As a result, the Respondents did not act with scienter.

III. Scienter: *Morningstar* Report March 31, 2011. The Decision erroneously concludes the Respondents acted with scienter by failing to disclose the SEC investigation in the report.

53. The Decision found that in regard to the September 30, 2010, *Morningstar* report, which claimed erroneously, that Ashland had audited[3] the firm acted only negligently through Bauchle with no intent to defraud. Decision, page 55. However, the Decision then states that as

[3] Feliz testified that the use of the word "audit" in an advertisement was not material and did not jeopardize a claim of GIPS compliance. TR-1068, 1069.

to the March 31, 2011, *Morningstar* report, ZPRIM acted with scienter in failing to disclose the SEC investigation since Bauchle (who was responsible for keeping the data base current) acted with "willful blindness" and was thus reckless. The Decision also concluded that the failure of Bauchle to update the *Morningstar* report regarding the SEC investigation was not "an intentional effort to mislead...," Decision, page 56. Evidence was produced that the SEC investigation was disclosed on the *Morningstar* report when the charges were identified in the Wells notice and the firm's Form ADV was amended to disclose the investigation. RX-28. The Decision confusingly places importance on the answer of Max Zavanelli as to how he would have answered the question on the *Morningstar* data base regarding the SEC investigation even though the evidence was clear that Max Zavanelli had no involvement in providing information to *Morningstar*. TR-269, 270. Max Zavanelli testified that he would have checked the box "no" when asked if there was an investigation. However, omitted from the Decision was the testimony of Max Zavanelli explaining why he would have answered "no". Max Zavanelli testified that if the box were checked "yes," the next question then asks you to disclose the charges and the date. Up until the Wells notice there were no charges and no date relating to the charges. Max Zavanelli also testified that his son, Mark Zavanelli, who became the chief operating officer of the firm, checked with *Morningstar* who stated if there were no charges, you answer the question "no". TR-1714. Under the rational of *Bryant, supra,* it is clear that the Respondents were not reckless and therefore, they did not act with scienter. Finally, the evidence also showed that the general public did not have access to the *Morningstar* data base. RX-37. The information was only available to institutional investors who paid *Morningstar* fees for access. *Id.* Mark Zavanelli testified that he individually purchased a general subscription package from

Morningstar and when he searched under ZPRIM there was no reference to the firm. TR-1797, 1798.

IV. Materiality: The Decision erroneously concludes that the misrepresentations in the advertisements were material since an investor would have considered the information to be important in deciding to invest and the omitted facts would have significantly altered the 'total mix' of information.

54. The Decision relies heavily on the fact that the 2008 advertisements reported five, ten and twenty-year returns, which showed strong returns that were double and triple the SCV Composite benchmarks. If one year returns and period to date had been used as required by the GIPS Advertising Guidelines, the data would have shown that the SCV composite was negative and underperforming one of the benchmarks, the Russell 2000 index. Decision, page 57. The Decision makes no reference to all of the additional information that was available on the ZPRIM website and being provided to prospective clients, which included the one year returns and the period to date returns that accurately reflected the negative performance for those periods and the underperformance of the benchmark. *See* RX-8 through RX-11. This "total mix" of information that ZPR provided to a prospective investor demonstrated there was full and fair disclosure of all material facts. The Decision's reliance upon *Riggs Investment Management Corp. v. Columbia Partners, LLC,* 966 F.Supp. 1250 (D.D.C. 1997), as being similar to the present case is misplaced. *Riggs* did not involve the Investment Advisers Act of 1940, as amended (the "Adviser's Act") and was a civil dispute involving money managers that left one firm to join another firm and then represented in advertising that the performance in the new firm spanned a period of six (6) years. The new firm linked the performance results from the old firm to create the impression that the performance at the new firm spanned a period of six years, which was clearly misleading and violated the AMIR guidelines (GIPS predecessor). *Id.* at 1268. Those facts had nothing to do with complying with GIPS Advertising Guidelines. The

Decision then determined that the representations in the *Morningstar* reports regarding the verification through the present was inaccurate when the evidence demonstrated that the firm had been GIPS compliant since December 31, 2000 through the present. Therefore, when the "total mix" of information is evaluated, a claim of GIPS compliance by ZPRIM within the advertisements and the *Morningstar* data is not material nor is it misleading unless viewed in isolation which is not the law.

V. Associational Bar: The Decision erroneously concludes that Max Zavanelli should be subject to a permanent associational bar.

(A) ZAVANELLI SHOULD NOT BE SUBJECT TO A PERMANENT BAR.

55. If the Commission accepts Respondents' position on the merits, it follows that the sanctions imposed by the Decision against both ZPR and Zavanelli cannot stand. However, even if the Decision's findings of violations of the Adviser's Act are upheld in whole or part, the Commission can and should modify the sanctions so that Zavanelli is not subject to a permanent associational bar. This ultimate sanction is not justified by the facts or law; it is punitive rather than remedial because a less comprehensive sanction would adequately serve any need to protect against a recurrence; it ill-serves the public interest because it would impede ZPR's existing and future clients' access to Max Zavanelli's investment advice, though the quality and integrity of that advice, over some 30 years, is unchallenged; and the Decision, on its face, strongly suggests that the ALJ's personal irritation with Max Zavanelli and his consideration of substantial evidence relating to issues that the Respondents were not charged with by the SEC improperly influenced his decision to impose a permanent bar.

(a) The *Steadman* Factors Do Not Support A Permanent Bar

56. ***Zavanelli's Conduct Was Not Egregious.*** There is little authority providing guidance for what constitutes egregious conduct for purposes of the *Steadman* analysis. Generally, courts have afforded the word its dictionary meaning: "extremely or remarkably bad; flagrant." *Rosado v. Barnhart*, 340 F.Supp.2d 63, 67 (D. Mass. 2004), *quoting* Black's Law Dictionary (7th ed. 1999). On its face, this is a high bar, and obviously conduct may amount to a violation without being egregious.

57. The Decision devotes but a single paragraph to addressing whether the conduct at issue in this case was egregious for sanctions purposes. Decision, page 61. And that one paragraph is concerned exclusively with equating Respondents' conduct to the violations found in *In the Matter of Seaboard Investment Advisers, Inc.*, 54 S.E.C. 111(2001). Yet this case and *Seaboard* are vastly different. In *Seaboard*, the individual respondent, Hansen, sent letters to advisory clients affirmatively misrepresenting the performance of their accounts in relation to benchmark indices. He went so far as to alter the performance of one referenced index. In addition, Hansen ignored internal procedures for securing approval of the client letters before they were sent, and his misconduct occurred while he already was subject to a consent injunction issued in conjunction with a prior 12-month associational suspension. *Id.* at 1112-14.

58. By contrast, it is undisputed that all ZPR clients received GIPS-compliant presentations before they opened accounts. The record contains no evidence that any client ever even saw any of the magazine advertisements at issue in this case, much less was misled by them. Nor is there any evidence that any client ever saw the challenged *Morningstar* reports; in any event, those reports are irrelevant to Zavanelli's sanctions because the Decision

acknowledges that a different individual, former ZPR employee Bauchle, was responsible for the *Morningstar* database. Decision, pages 55-56.

59. It is true that clients received the newsletters, two of which, sent out in 2009, failed to conform to GIPS' Advertising Guidelines. Yet the newsletters bear no resemblance to the misrepresentations in *Seaboard.* Unlike in *Seaboard*, no false performance data was presented in either of the ZPR newsletters. Rather, as with the magazine ads, the issue was the newsletters' reference to ZPR's compliance with GIPS – a reference that was *true* with respect to the only thing that a reasonable investor would care about: how ZPR's investment performance was calculated. As with the magazine ads, the newsletters contained a technical violation of GIPS Advertising Guidelines, but *not* any misrepresentations as to performance or how it was calculated. And even here, the Decision found that Zavanelli "genuinely believed" the newsletters were not even subject to the Advertising Guidelines. Decision, page 54.

60. Thus, the Decision's asserted reason for finding Zavanelli's conduct egregious – that it was closely similar to the conduct in *Seaboard* – cannot withstand scrutiny. The very brevity of the Decision's discussion of this point indicates that the ALJ did not meaningfully consider the egregiousness factor when he determined Zavanelli's sanction. *See Monetta Financial Services, Inc. v. SEC*, 390 F.3d 952, 957 (7th Cir. 2004) ("Although the SEC's opinion references these factors, the opinion does not reflect that the SEC meaningfully considered these factors when it imposed sanctions.") (footnote omitted).

61. Apart from the stark differences between this case and *Seaboard*, a conclusion that Zavanelli's conduct was egregious – that it was "extremely or remarkably bad" or "flagrant" – deprives that word of any meaningful utility in the determination of sanctions. It is one thing to cause direct financial injury to a client, *see Gonchar v. SEC*, 409 Fed.Appx. 396, 400 (2nd Cir.

2010) (conduct was "egregious" and warranted bar where customers were charged excessive markups), or where an advisor has pleaded guilty to criminal securities fraud and to lying to the Commission, *Korman v. SEC*, 592 F.3d 173 (D.D.C. 2010). *That* is egregious behavior. But nothing remotely like that occurred here. There was never even a possibility that any client would be misled about ZPR's performance because it is undisputed that every client received a GIPS-complaint presentation before being allowed to invest, and the firm's performance, presented in compliance with GIPS, also was publicly available on its web site. Nor does this case involve any false representations of ZPR's actual performance. At most, as it relates to Zavanelli, this case involves a rather arcane distinction between how GIPS requires a firm to *calculate* its investment performance, on one hand, and the format that GIPS' Advertising Guidelines prescribes for *communicating* that performance. To call the mistakes in ZPR's ads "egregious" is to diminish the exceptional meaning of that word.

(b) *The "Recurrence" Factor Does Not Support A Permanent Bar*

62. The Decision is too glib in declaring that "[r]espondent's eleven violations between October 2008 and March 2011 were obviously recurrent." Decision, page 61. That conclusory assertion elides important distinctions. Six of the 11 violations consisted of magazine advertisements, published in 2008 and 2011 (but not 2009 or 2010). What the record, but not the Decision, makes clear is that these six advertisements resulted from just two decisions. The first was ZPR's decision to enter into a three-ad purchase agreement with *SmartMoney* for publication of the October, November and December 2008 ads. In the second decision, ZPR contracted with *Pensions & Investments* magazine for permission to reprint certain tables, originally published in that magazine, which compared ZPR's performance to peer money managers. The contract required ZPR to reprint the tables as they had been published in

Pensions & Investments. As a result, ZPR reprinted the tables in ads in the February and May 2011 editions of *SmartMoney* and the March 21, 2011 edition of *Barron's*. The same sin was committed in each of the six ads – the inclusion of a statement that ZPR was GIPS-compliant without setting forth all information called for by GIPS' Advertising Guidelines. But when the six magazine ads are properly viewed as the results of just two distinct publishing decisions, calling them "recurrent" violations is a distortion.

63. The magazine ads also were qualitatively different from the 2009 client newsletters and the 2011 *Morningstar* reports that constituted the remainder of the 11 "recurrent" violations. As the Decision acknowledged, Zavanelli genuinely believed the client newsletters were not advertisements, and thus they can hardly be seen as a "recurrence" of the alleged ad violations. Nor can the *Morningstar* reports fairly be characterized as "recurrences" of either the ad or newsletter violations. In any event, the Decision acknowledged it was not Zavanelli, but rather former ZPR employee Bauchle, who was responsible for the *Morningstar* reports at issue, and so those reports cannot count against Zavanelli as "recurring" violations. *See* Decision, page 55 ("Bauchle was the only one involved with updating the *Morningstar* database during the relevant period. Tr. 269-71. There was no evidence that Max Zavanelli directed Bauchle on how to answer the questions in the *Morningstar* database.")

64. The Decision's conclusion that *Steadman*'s recurrence factor weighs heavily in favor of the sanctions against Zavanelli is at least a litigable issue that should be reviewed by the Commission.

(c) *The Scienter Factor Does Not Support A Permanent Bar*

65. The Decision is especially curt in its discussion of *Steadman*'s scienter factor as it relates to sanctions:

> Respondents' degree of scienter for each violation varied. As to the magazine advertisements, the scienter was relatively high, because Zavanelli intended to conceal his poor performance from investors. As to the newsletters and the March 31, 2011, Morningstar report, the scienter was relatively low, because Zavanelli sincerely, but recklessly, believed that the newsletters were not advertisements, and because Bauchle was willfully blind to the fact of the Commission's investigation. As to the September 30, 2010, Morningstar report, there was no scienter because the violation involved only negligence.

Decision, page 61.

66. Even taking these conclusions at face value, they do not support the draconian remedy of a permanent bar for Zavanelli. As the Decision notes, it found a total of 11 violations. Decision, page 61. Six of these were for the magazine advertisements, but these six were the only violations which are said to have entailed a "relatively high" degree of scienter. The remaining five violations – two in the newsletters and three in *Morningstar* reports – involved only "relatively low" scienter or, in the case of the September 30, 2010, *Morningstar* report, no scienter at all. And *none* of the *Morningstar* reports can count against Zavanelli for *Steadman* purposes, given the Decision's finding that he had no responsibility for those reports. Accordingly, so far as Zavanelli is concerned, more than 45% of the violations – five out of the 11 – involved either "relatively low" or *no* scienter. In that light, it cannot be said that *Steadman*'s scienter factor supports the regulatory equivalent of the death penalty against Zavanelli. *See, e.g., In the Matter of Leo Glassman*, 46 S.E.C. 209, 211-12 (1975) (although Commission viewed respondent's conduct "as extremely serious" and violations were committed while respondent was already under a consent injunction, record supported six-month suspension rather than 15-month bar with right to reapply for restricted positions, as the ALJ had ordered).

67. The scienter factor loses even more force when one considers – as the Decision's sanction analysis did not – various mitigating factors in the record. *See PAZ Securities, Inc. v.*

SEC, 566 F.3d 1172, 1174 (D.D.C. 2009) (reversing and remanding where Commission failed to properly consider mitigating factors). Most important of these was the undisputed fact that each and every ZPR customer received a GIPS-compliant presentation before investing. Supplying such presentations substantially diluted, if it did not completely eliminate, any deceptive effect of the reference to GIPS compliance contained in the ads' footnote. So did the public availability of GIPS-compliance performance information on ZPR's web site. Put another way, it simply makes no sense to say the ads involved a "relatively high" degree of scienter when ZPR did not permit anyone to invest before receiving indisputably complete and truthful information.

(d) ***No Likelihood Of Future Violations***

68. *Steadman* also directs consideration of the sincerity of respondent's assurances against future violations and whether his occupation will present opportunities for future violations. Here, Zavanelli can point not merely to words but to actions – as of October 2013, he turned over complete ownership of ZPR to his son, Mark Zavanelli. Under the new owner's stewardship, ZPR has hired a new outside compliance firm and taken other steps to insure that GIPS-related occurrences will not reoccur that the Decision clearly recognized. Decision at page 35, 36. Max Zavanelli is no position to interfere with these remedial steps.

69. Nor does he ever want to be. If the Commission does not reverse the Decision's findings of violations by Zavanelli, it can nevertheless modify the permanent bar so as to preclude him from having any ownership of or decision-making authority over ZPR, while still allowing him to continue to provide strategic investment advice to the firm for the benefit of its customers. Zavanelli is prepared to accept such a modified bar if the Commission otherwise rejects his appeal of the Decision. In this scenario, Zavanelli's role at ZPR would be strictly limited and subject at all times to oversight. He could make no decisions binding on the firm,

but instead merely provide ZPR and its customers with his best advice regarding investment strategy. Nothing in the record raises any doubts about the quality or integrity of Zavanelli's investment advice over the 30 years since he founded the firm. Modifying the bar to allow Zavanelli to continue to offer such advice to ZPR's clients would serve the interest of the investing public. Permanently barring him from doing so would be improperly punitive and serve no remedial objective. *See, e.g., Beck v. SEC*, 430 F.2d 673, 674 (7th Cir. 1970) ("orders issued by the Commission are intended to be remedial, not punitive").

70. A modified bar is especially appropriate in light of the Decision's statement that ZPR "has provided sincere assurances against future violations and recognized the wrongful nature of its conduct." Decision, page 61. This acknowledgment that the firm is not likely to commit future violations also provides assurance that Zavanelli would not be in a position to do so if his role were limited to providing investment advice, without his having any involvement in any other aspect of the firm's business.

(e) *Zavanelli's Acceptance Of Responsibility*

71. It is ironic that the Decision recognizes the sincerity and reliability of ZPR's assurances against future violations while crediting Zavanelli with none. It was, after all, Zavanelli who gave up all of his interest in ZPR, after this dispute arose, and installed the new owner who instituted the reforms that the Decision recognizes as likely to prevent future violations.

72. The Decision appears to hold it against Zavanelli that he defended against the Staff's allegations. Yet that cannot properly be deemed a factor in the sanctions determination. *See SEC v. Johnson*, 595 F.Supp.2d 40, 45 (D.D.C. 2009), *quoting SEC v. First City Financial Corp.*, 890 F.2d 1215, 1229 (D.C. Cir. 1989):

> The SEC also argues that Benyo has not recognized the wrongful nature of his actions because he testified in a July 2007 deposition that he thinks he did nothing wrong. Needless to say, Benyo has a right to vigorously contest the SEC's allegations and was not required "to behave like Uriah Heep in order to avoid an injunction."

73. In fact, it is impossible to read the Decision without suspecting that the ALJ's annoyance with Zavanelli's pugnacious personality influenced his decision to impose the harshest possible sanction against Zavanelli. The Decision devotes three single-spaced pages to a remarkable attack on Zavanelli's "demeanor," complaining about his "combativeness, evasion, and non-responsive answers" during investigative testimony. Decision, page 43. To be sure, Zavanelli did not always appear to be trying to charm either the Staff or even his own counsel when he was on the stand. Given that Zavanelli is not a legal professional but a layman who was defending himself and the enterprise that is his life's work against charges of fraud, it is hardly surprising that he was sometimes a difficult witness. On the other hand, in the colloquy that the ALJ chose to quote, Zavanelli *apologized* no fewer than four times when he realized that his impatience or his tendency to digress had gotten the better of him. Decision, pages 44-45. Fairly assessed, the record does not justify the conclusion that Zavanelli fails to appreciate the mistakes that he made and refuses to accept responsibility for them. Pages 43 through 45 of the Decision, however, raise disturbing questions about whether Zavanelli was improperly penalized for behavior that should have no legal significance.

VI. Civil Penalties: The Decision erroneously concludes the conduct in questions warrants second tier penalties rather than first tier penalties.

74. For the reasons just discussed, the Decision erred in concluding that application of the *Lybrand* factors supports assessment of second-tier penalties against both respondents. Decision at 63-64. This is true even if the Commission were to accept that the magazine ads,

newsletters or *Morningstar* reports operated as a fraud or deceit (despite the complete lack of evidence that anyone was defrauded or deceived). It is well established that a fraudulent *effect* may result from conduct that is merely negligent, in which case first-tier rather than second-tier penalties are appropriate. *SEC v. Moran*, 944 F.Supp. 286, 297 (S.D.N.Y. 1996) ("While the language of the statute describing the Second Tier penalty includes fraudulent conduct, there is an unmistakable difference between conduct which negligently operates as a fraud when compared to conduct engaged in with the intent to defraud clients.") At worst, respondents were negligent in failing to appreciate the implications of a reference to GIPS-compliance in a small-type footnote in the magazine ads, in failing to consider the newsletters as "advertisements" for GIPS purposes, and in their interpretation of *Morningstar's* reporting requirements. The absence of fraudulent intent is clear from, among other circumstances discussed above, respondents' undisputed provision of GIPS-compliant presentations to each and every investor prior to opening an account.

C. IMPORTANT POLICY CONSIDERATIONS

I. Whether the failure to follow a voluntary advertising guideline makes a claim of GIPS compliance misleading when there has been compliance with all of the GIPS standards?

75. There was no evidence presented by the Commission that the Respondents failed to comply with any of the GIPS standards. To the contrary, the evidence demonstrated that ZPRIM had complied with all of the GIPS standards over a period of 12 years. It is important to note the GIPS Advertising Guidelines specifically state the guidelines do not replace the GIPS standards. *See* Exhibit RX-3, page 33; RX 4, page 29, GIPS Advertising Guidelines. As a result, the Advertising Guidelines cannot be considered to be GIPS standards. Therefore, if a firm claims in an advertisement that it is GIPS compliant, the representation only relates to the

GIPS standards and not the GIPS Advertising Guidelines. As a result, when ZPRIM claimed that it was a GIPS compliant firm in the advertisements, the statement was accurate and not misleading since ZPRIM had complied with all of the GIPS standards. This becomes important since there was no charge in the OIP that failing to follow the GIPS Advertising Guidelines is a violation of the Adviser's Act.

76. The Decision effectively concludes that a failure to follow any requirements under the GIPS Advertising Guidelines without consideration of any other information that is available to prospective client shall result in strict liability under the Adviser's Act. This result does not consider important factors such as good faith, materiality, substantial compliance, or the lack of false or misleading statements pertaining to an advertisement that simply departs from the GIPS Advertising Guidelines. Mistakes and errors are clearly contemplated by the GIPS Standards through error correction policies and GIPS was never intended to represent an unwavering or inflexible set of rules. The Decision, if left undisturbed, will create a chilling effect amongst firms who currently or intend to claim compliance with GIPS for fear that mistakes made will result in harsh sanctions.

II. The Decision repeatedly refers to circumstances which were irrelevant to the issues charged in the OIP solely for the purpose of casting the Respondents in a negative light in order to justify the draconian sanctions.

77. The Decision repeatedly ventures into areas that were not included in the OIP, which is impermissible. *In Re Intl. Shareholder Servs.Corp.,* Fed.Sec.L.Rep (CCH), ¶80,493 (April 29, 1976), the Commission stated:

> If the staff thought it had a case in these areas, it should have touched on them in its pleading. Or having failed to do so the first time around, should have amended that pleading to raise fraud and quasi-fraud issues. But since the staff did not do that and since the order for proceedings does not even hint at fraud in any sense, the

> staff's effort to sneak fraud charges into the proceeding via the back door of 'public interest' was grossly improper.

78. At the outset of the hearing, the staff insisted upon having a subpoena issued by the administrative law judge that required the Respondents to produce over 860,000 documents. The request caused a continuance and forced the Respondents to scramble to comply with the subpoena while not preparing for the hearing. The documents requested spanned periods of time that were not related to the time periods in the OIP. The Respondents objected to the subpoena which was overruled and the administrative law judge ultimately deemed that there had been compliance with the subpoena. After the production of the documents, which were e-mails between various personnel at ZPRIM, the e-mails were then used to examine Mark Zavanelli and Max Zavanelli. Many of the e-mails discussed the SEC investigation in an unfavorable light. The OIP does not include any charges that the firm's books and records were deficient but the Commission requested an adverse inference in the proceeding for allegedly withholding and spoliation of evidence during the examination. *See* Decision, page 42. It is also important to note that upon the conclusion of the firm's examination, the deficiency letter did not list any problems with the books and records of the firm. This evidence relating to the e-mails was used in the Decision in evaluating both liability and sanctions. *See* Decision, pages 37-43.

79. In regard to the issue of the e-mails, the following dialogue regarding the involvement of Max Zavanelli with the firm after he resigned and his son assumed the responsibilities of the chief operating officer. The dialogue was between counsel and the administrative law judge concerning how Max Zavanelli was answering questions as follows (*see* TR-1623 – 1625):

Mr. Snyderburn: Yes, You Honor. Just for purposes of the record, the OIP in this particular case involves eight advertisements and a *Morningstar* publication. What I've listened to over the last three-and-a-half hours in the examination are events that took place in '11, '12 and '13.

I have not seen admitted one e-mail, I believe from the OA period. And what I'm trying to figure out, and we've agreed to stipulate, Mr. Zavanelli is involved in the business, but I'm trying to figure out how this relates to the charges that are in the OIP. I mean, if Mr. Zavanelli was still the president of the company, what does that have to do with the price of tea in China, as it relates to the eight charges?

It seems to me what we need to focus on is did we violate the securities laws on those eight ads.

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But we have spent yesterday afternoon and this morning on Exhibits 115 through 145, and the only thing we've heard is are you involved in the business. And all of a sudden, it seems my client is now being blamed for this ---- you know, he's not answering the questions the right way.

80. This also troubled the administrative law judge when the Commission requested a three week continuance on the first day of the hearing. *See* TR-22.

Judge Elliot: Okay. I disagree with you. Here's what you're going to do – or here's what I recommend you do. Obviously, this is not up to you or me. If you think there has been some sort of concealment, spoliation, whatever you want to call it, bring another charge against him. Bring another OIP for failure to cooperate with the examination or something like that.

But, until Sunday, you thought you could prove your case with the evidence you had, right? So I think we should to that. I mean, you don't even know what's in this evidence, right?

81. In addition to the e-mails not being an issue in the OIP, the Decision also relied upon other advertisements that were not included in the OIP. *See* Decision, page 28, "Additional Advertisement Issues."

82. The Decision also references that ZPRIM used carve-outs in it GIPS complaint presentations without disclosing the carve-outs. There is no mention in OIP of the

advertisements being deficient due to the failure to disclose the carve-outs and therefore, any reference to these matters should be excluded. *See* Decision, page 11.

83. The Decision also references that certain advertisements did not disclose the currency that was being utilized in determining the performance. There is no charge in the OIP that failing to disclose the currency in the advertisements renders the advertisements misleading and therefore any reference to these matters should be excluded.

84. The Decision also references that the advertisements did not clearly disclose how an investor could receive a GIPS compliant presentation. There is no charge in the OIP that the advertisements were misleading due to this lack of disclosure and therefore any reference to these matters should be excluded. *See* Decision, page 15 and footnote 13.

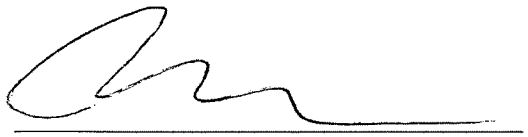
85. As a result of having to defend matters that were not included in the OIP, all reference to these extraneous issues, as described above, should be stricken including all documents that were admitted into evidence that do not relate to the charges.

IV. CONCLUSION

86. The draconian penalties that have been recommended by the ALJ for failing to properly footnote six (6) advertisements; mistakenly referring to GIPS in the two investment newsletters; neglecting to remove the word "audit" and change a date in one *Morningstar* report; and possibly misunderstanding a *Morningstar* instruction relating to a "Pending SEC Investigation Charge" are simply unwarranted. If ZPRIM had not said that it was a GIPS compliant firm in the advertisements or newsletters raised in the OIP, no investigation or administrative proceedings would have been commenced since there has never been any other allegation or contention by the Commission that such advertisements or investment newsletters were misleading or fraudulent. Common sense dictates that a five star rated *Morningstar* adviser

should not be banned for life due to a footnote or other mistake that caused no financial or other harm to the public.

Respectfully submitted.



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