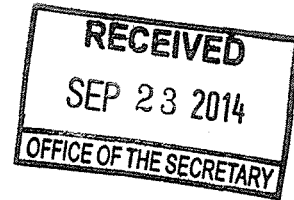


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**UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
September 22, 2014**

**ADMINISTRATIVE PROCEEDING
File No. 3-15263**

In the Matter of :
:
:
ZPR INVESTMENT MANAGEMENT, INC., :
AND MAX E. ZAVANELLI, :
:
Respondents. :
:



**DIVISION OF ENFORCEMENT'S RESPONSE TO
RESPONDENTS' APPEAL OF INITIAL DECISION**

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I. INTRODUCTION

As the Law Judge correctly determined, the evidence presented at the hearing in this case established that Respondent ZPR Investment Management, Inc. (“ZPRIM”) violated the Investment Advisers Act of 1940 (“Advisers Act”) by misrepresenting compliance with Global Investment Performance Standards in magazine advertisements and investment report newsletters, and further violated the Advisers Act by making misrepresentations in two Morningstar Reports. The evidence also clearly supports the Law Judge’s findings that Respondent Max E. Zavanelli aided and abetted ZPRIM’s violations in the magazine advertisements and investment report newsletters.

As a result of its repeated violations of the Advisers Act, the Law Judge properly sanctioned ZPRIM by imposing a censure, cease-and-desist order, and a civil penalty of \$250,000. The Law Judge also correctly sanctioned Zavanelli by imposing an industry-wide associational bar, a cease-and-desist order, and a civil penalty of \$660,000.

ZPRIM and Zavanelli make a number of arguments as to why the Law Judge purportedly erred in his Initial Decision – all of which the Law Judge already considered and correctly rejected. The Respondents’ arguments fall generally into two broad categories. First, they focus on the credibility of Zavanelli and the content of the misrepresentations and omissions in ZPRIM’s advertisements and Morningstar reports, while ignoring the Law Judge’s detailed credibility findings and the substantial evidence the Division of Enforcement presented and on which the Law Judge relied. As to the advertisements and Morningstar reports, the Respondents mischaracterize the evidence to argue they merely included faulty footnotes of little significance. This ignores the undisputed evidence on which the Law Judge relied that the advertisements misrepresented ZPRIM’s performance returns and falsely stated ZPRIM was over-performing its

benchmark indexes when, in truth, ZPRIM was underperforming them, and the Morningstar Reports falsely stated there was no Commission investigation when, in truth, the Respondents knew the Commission was investigating ZPRIM.

Second, the Respondents erroneously argue the Division failed to prove: Zavanelli acted with scienter; the misstatements and omissions were material; and second tier penalties and a permanent bar against Zavanelli are warranted. The Respondents ignore the overwhelming evidence that Zavanelli acted with an intent to deceive investors and the misrepresentations and omissions concerned ZPRIM's performance results and the Commission's investigation of ZPRIM – facts any investor would clearly want to know.

The Respondents' other arguments are similarly flawed. The Commission should uphold the Initial Decision and the sanctions the Law Judge imposed.

II. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

A. The Order Instituting Administrative Cease-and-Desist Proceedings

The Commission issued the Order Instituting Administrative Cease-and-Desist Proceedings ("OIP") in this matter on April 4, 2013 against ZPRIM and Zavanelli. In summary, the OIP alleged that ZPRIM, through Zavanelli, made false claims that its performance result presentations complied with Global Investment Performance Standards ("GIPS") in six magazine advertisements in October, November, and December 2008, and in February, March, and May 2011.¹ GIPS is a standardized set of voluntary, ethical principles for investment advisers; it is published by the CFA Institute, is based on ideals of full disclosure and fair representation, and includes guidance on how to calculate and report investment performance results to prospective

¹ OIP at 2-5.

clients.² GIPS includes specific guidelines required for performance advertisements when those advertisements claim GIPS compliance.³ The OIP alleges that by omitting GIPS-required information in the October, November, and December 2008 advertisements, ZPRIM concealed the fact that it was underperforming one of its benchmarks rather than outperforming it.⁴

The OIP further alleges that: (1) ZPRIM, through Zavanelli, distributed monthly investment report newsletters that falsely claimed GIPS compliance in April and December 2009; (2) ZPRIM, through Zavanelli, falsely claimed in Morningstar reports for the periods ending September 30, 2010, and March 31, 2011, that there was no pending Commission investigation of ZPRIM; (3) ZPRIM falsely claimed in the September 30, 2010, Morningstar report that performance returns of ZPRIM's Fundamental Small Cap Value Composite (SCV Composite) had been "audited" by Ashland Partners & Company, LLP (Ashland), instead of correctly reporting that Ashland had "verified" the results' compliance with GIPS; and (4) the September 30, 2010, Morningstar report falsely claimed Ashland had audited ZPRIM's SCV Composite performance returns for the period "December 31, 2000 to the present," when Ashland had resigned as ZPRIM's GIPS verifier in July 2010, and Ashland's last attestation report for ZPRIM concerned results for the period ended December 31, 2009.⁵

The OIP alleges that ZPRIM willfully violated Sections 206(1) and 206(2) of the Advisers Act; Zavanelli violated or, in the alternative, aided and abetted and caused ZPRIM's violations of, Sections 206(1) and 206(2) of the Advisers Act; and ZPRIM willfully violated, and

² *Id.* at 3.

³ *Id.* at 2-5.

⁴ *Id.* at 1-2.

⁵ *Id.* at 5-6.

Zavanelli aided and abetted and caused ZPRIM's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by advertising untrue statements of material fact.⁶

ZPRIM and Zavanelli filed a joint Answer on April 29, 2013. The Respondents admitted in their Answer that the six magazine advertisements from October, November, and December 2008, and February and May 2011, standing alone, failed to comply with GIPS advertising guidelines, but denied the advertisements constituted materially misleading claims of performance returns.⁷ The Respondents also admitted that the September 30, 2010, Morningstar report incorrectly stated that Ashland "audited" its performance results and had not attested to performance results past December 31, 2009, but averred these were typographical errors and were not materially misleading. *Id.* at 6-7. The Respondents otherwise denied the allegations in the OIP.

B. The Initial Decision

In September and October 2013, the Law Judge held a seven-day public hearing in Washington, D.C. The Law Judge issued his 66-page Initial Decision on May 27, 2014.⁸ The Law Judge found the Respondents engaged in eleven violations of the federal securities laws between October 2008 and March 2011.⁹ Specifically, the Law Judge found ZPRIM violated Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act by misrepresenting compliance with GIPS in the magazine advertisements and investment report newsletters, and violated Sections 206(2) and 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act by making

⁶ *Id.*

⁷ Answer at 3-6.

⁸ Initial Decision Release No. 602.

⁹ *Id.* at 61

misrepresentations in the two Morningstar Reports.¹⁰ The Law Judge also found Zavanelli aided and abetted ZPRIM's violations of Sections 206(1), 206(2), and 206(4) regarding the magazine advertisements and investment report newsletters.¹¹

1. The Respondents

a. Zavanelli

The Law Judge correctly found that in 1987, the Commission made findings, pursuant to an offer of settlement from Zavanelli and Zavanelli d/b/a Zavanelli Portfolio Research, that he, without admitting or denying any allegations, violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) for performance return claims in a 1986 Form ADV and for claims regarding his educational background in a 1982 Form ADV.¹² Zavanelli and Zavanelli Portfolio Research were censured and prohibited from soliciting or accepting new clients for 180 days.¹³ In 1994, Zavanelli split Zavanelli Portfolio Research into three separate companies: ZPRIM, ZPR International, and ZPR Investment Research.¹⁴ ZPRIM is the subject of this proceeding, ZPR Investment Research is no longer active, and ZPR International continues operating from Lithuania and Zavanelli remains an owner.¹⁵

¹⁰ *Id.* at 46-59.

¹¹ *Id.* at 59.

¹² *Id.* at 4.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

Zavanelli was the president of ZPRIM from its inception until October 2011, and chief compliance officer from 2009 until October 2011.¹⁶ In October 2011, Zavanelli transferred 25 percent of the company's shares to his son and made his son the president and chief compliance officer, and Zavanelli transferred his remaining shares to his son during the hearing in this proceeding.¹⁷ Until December 2011, Zavanelli made all final decisions on behalf of ZPRIM.¹⁸ Zavanelli was responsible for, and had final authority over, the creation, distribution, and publication of all marketing and advertising materials for ZPRIM.¹⁹ Zavanelli admitted he was responsible for ensuring ZPRIM's marketing materials were GIPS compliant and for making all claims of GIPS compliance on ZPRIM's behalf.²⁰

Zavanelli remains heavily involved in ZPRIM's business, and continues to serve as ZPRIM's director and treasurer.²¹ Zavanelli continues to make investment decisions for ZPRIM and receives daily reports from ZPRIM on performance and valuation.²² He regularly consults with his son, who is currently president of ZPRIM, and they discuss and make decisions together about ZPRIM.²³

¹⁶ *Id.*

¹⁷ *Id.* at 5.

¹⁸ *Id.* at 4.

¹⁹ *Id.* at 5.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

b. ZPRIM

The Law Judge correctly found ZPRIM is a registered investment adviser located in Florida.²⁴ As of its last Form ADV, filed December 12, 2013, ZPRIM had approximately 105 clients and approximately \$164 million in assets under management.²⁵ ZPRIM began with four employees when it opened in 1994, has fluctuated in size to as many as sixteen employees, and currently has five employees.²⁶ ZPRIM maintains several composites, including the SCV Composite, the Global Equity Composite, the Earnings Quality and True Profitability (EQTP) Composite, and the All Asian Composite.²⁷ ZPRIM continues to claim GIPS compliance.²⁸

2. The Law Judge's Findings Concerning GIPS

The Law Judge found that beginning in October 2008 until May 2011, ZPRIM made false claims of GIPS compliance in six magazine advertisements and two investor newsletters.²⁹ The Law Judge correctly found: GIPS is a set of voluntary ethical standards that investment firms can choose to follow for reporting investment performance results; GIPS was developed to standardize performance result reporting to provide comparability and facilitate investor confidence in reported returns; and it is considered a "best practice" in the investment industry.³⁰ GIPS has become almost mandatory for firms seeking institutional investors, and firms that are

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 13.

²⁹ *Id.* at 47-49.

³⁰ *Id.* at 8.

not GIPS compliant are unlikely to appear in final searches for investment advisers by institutional investors.³¹

GIPS is voluntary, but if a firm claims that it complies with GIPS, it has an obligation to follow all of the standards and requirements.³² The Respondents' argument that the Law Judge erroneously found firms claiming GIPS compliance must meet all the GIPS requirements is wrong.³³ The Law Judge correctly found that firms that do not meet all of GIPS' requirements cannot represent that they are in compliance with GIPS.³⁴ This finding was supported by the language of GIPS, as well as the testimony of ZPRIM's GIPS verifier, Nikola Feliz.³⁵ GIPS states that a firm claiming GIPS compliance must meet all required elements of the GIPS standards.³⁶ One of the requirements is following the GIPS advertising guidelines in advertisements where a firm claims GIPS compliance.³⁷

The Respondents do not dispute the advertisements at issue included claims of GIPS compliance and did not comply with the GIPS advertising guidelines. Nonetheless, we include a brief discussion of the Law Judge's findings about what the GIPS advertising guidelines require. Pursuant to GIPS, all advertisements that make a claim of GIPS compliance must include

³¹ *Id.* at 9.

³² *Id.*

³³ Respondents' Brief at 8.

³⁴ Initial Decision at 8-9.

³⁵ *Id.*, citing DX 25.

³⁶ DX 25 at 16 (Claim of Compliance – Requirements).

³⁷ DX 25.

disclosures in accordance with an itemized list in the advertising guidelines.³⁸ Relevant to this proceeding are that firms must disclose: performance returns for specific periods set forth in GIPS;³⁹ a description of how an interested party can obtain a “GIPS-Compliant Presentation” and/or a list and description of all firm composites; the currency used to express returns; which returns are noncompliant if including returns from periods prior to January 1, 2000; and whether performance returns are gross or net of fees.⁴⁰

The GIPS advertising guidelines also require firms claiming GIPS compliance to provide specific performance return information for the firm’s composites in their advertisements. Advertisements in which a firm claims GIPS compliance must, under the 2005 GIPS Guidelines, include either: (A) a period-to-date composite return with one, three, and five-year cumulative annualized composite returns, with end-of-period date clearly identified; or (B) five years of annual composite returns, with the end-of-period date clearly identified.⁴¹ The 2010 GIPS Guidelines modified the requirements for performance return reporting in advertisements, requiring either: (A) one, three, and five-year annualized composite returns through the most recent period, with the end-of-period date clearly identified; or (B) period-to-date composite returns on top of one, three, and five-year annualized returns through the same period of time presented in the firm’s GIPS compliant presentation, with the end-of-period date clearly identified; or (C) period-to-date composite returns on top of five years of annual composite returns, with the end-of-period date clearly identified.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

Another requirement of GIPS is that firms claiming GIPS compliance must lump all fee-paying, discretionary accounts into composites that are defined according to investment strategy. Firms must clearly define their composites and adhere to their definitions as long as they claim GIPS compliance.⁴² A fundamental requirement of GIPS is that a firm claiming compliance must make every reasonable effort to provide a compliant presentation of its composites (“GIPS-Compliant Presentation”) to all prospective clients if it has not done so within the previous twelve months.⁴³

GIPS encourages, but does not require, that firms claiming GIPS compliance be verified by a third-party verifier; however, third-party verification has, practically speaking, become “almost mandatory” within the industry.⁴⁴ GIPS compliance ultimately rests with the firm, even if it chooses to be verified. The primary purpose of GIPS verification is to ensure that the firm claiming compliance with GIPS has in fact adhered to GIPS and that the firm’s procedures and processes are designed to calculate and present performance results in compliance with GIPS.⁴⁵

3. The Law Judge’s Findings Concerning the Respondents’ GIPS Compliance

As discussed above, the Respondents do not dispute that the advertisements at issue included claims of GIPS compliance and did not comply with the GIPS advertising guidelines. The Law Judge found ZPRIM included claims of GIPS compliance in the six magazine advertisements and two investment report newsletters at issue because ZPRIM and Zavanelli believed GIPS compliance was a prerequisite to attracting institutional clients and would

⁴² *Id.* at 9.

⁴³ *Id.*

⁴⁴ *Id.* at 10.

⁴⁵ *Id.*

therefore help ZPRIM attract these clients.⁴⁶ The Law Judge correctly found that when Zavanelli approved the advertisements for publication, he knew the advertisements did not comply with the GIPS advertising guidelines, but ran them anyway.⁴⁷

a. ZPRIM Begins Claiming GIPS Compliance in 2007

The Law Judge correctly found ZPRIM began claiming GIPS compliance no later than 2007, and Zavanelli was responsible for ensuring ZPRIM's marketing materials were GIPS compliant.⁴⁸ From the outset, ZPRIM claimed GIPS compliance for its performance returns reaching back to periods as early as 1987 or 1988.⁴⁹ ZPRIM linked performance returns from prior to January 1, 2001, and included carve-outs in at least one composite.⁵⁰ The Commission conducted examinations of ZPRIM in 1996 and 2009, and despite concerns by the examination team regarding the issue of carve-outs in pre-2001 performance returns during the 2009 examination, ZPRIM continued to report the early numbers in its advertisements and in its GIPS compliant presentations without disclosing the carve-outs.⁵¹

b. Zavanelli Has Final Say Concerning GIPS Compliance and ZPRIM Former Employee Ted Bauchle Provides the Numbers

Ted Bauchle, ZPRIM's former Vice President,⁵² became the "point person" for ZPRIM's GIPS compliance when ZPRIM began claiming GIPS compliance in 2006.⁵³ However,

⁴⁶ *Id.* at 51.

⁴⁷ *Id.* at 47.

⁴⁸ *Id.* at 11.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.* at 7.

Bauchle's role was limited to being the "numbers guy," according to Zavanelli, and Zavanelli had the final say on GIPS compliance.⁵⁴ Bauchle never received any formal training on GIPS, but he familiarized himself with GIPS by reading the GIPS handbook and by working with Ashland Partners & Company LLP, ZPRIM's first GIPS verifier.⁵⁵ Bauchle understood that a firm had to follow all of the GIPS guidelines when claiming GIPS compliance in advertisements.⁵⁶

c. In 2006, ZPRIM Retains Ashland as its GIPS Verifier

ZPRIM hired Ashland in early 2006 to verify its returns for periods between January 1, 2001, and December 31, 2005, and onward.⁵⁷ ZPRIM maintained an engagement with Ashland to verify ZPRIM's GIPS compliance on a quarterly basis through the period ended December 31, 2009.⁵⁸ Nikola Feliz, a senior manager at Ashland, testified for the Division on Ashland and its relationship with ZPRIM.⁵⁹ Feliz was involved with ZPRIM's engagement from start to finish, Bauchle was the main contact at ZPRIM, and Feliz communicated with Zavanelli on a few occasions.⁶⁰

Before beginning its first review, Ashland sent a letter to ZPRIM, asking for certain materials required to complete the verification. The letter noted that verification is a

⁵³ *Id.* at 11.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.* at 14.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

“continuous” process and Ashland would be providing quarterly reviews to ensure proper firm compliance.⁶¹ The letter also noted that verification would include a review of ZPRIM’s marketing, and Feliz testified Ashland requests marketing materials as part of all verifications.⁶² A February 26, 2006, follow-up letter requested ZPRIM’s “most recent marketing materials” for all ZPRIM composites.⁶³ On March 23, 2006, ZPRIM sent Ashland a representations letter, required by Ashland to complete verifications, representing that ZPRIM had provided all of its “performance presentation materials and disclosures” for Ashland’s review, and that the representations were accurate for subsequent periods of verification unless amended or withdrawn.⁶⁴ ZPRIM sent marketing materials to Ashland every quarter, but did not send Ashland the advertisements at issue in this case.⁶⁵

ZPRIM sent Ashland a January 2008 magazine advertisement.⁶⁶ Feliz and another Ashland employee advised Bauchle via telephone that the January 2008 advertisement was missing information required under the GIPS advertising guidelines.⁶⁷ While the Respondents attempted to impeach Feliz’s credibility on this issue, the Law Judge correctly found Feliz was

⁶¹ *Id.*

⁶² *Id.* at 14-15.

⁶³ *Id.* at 15.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

credible.⁶⁸ ZPRIM never sent any advertisements to Ashland after sending the January 2008 advertisement.⁶⁹

d. In Fall 2008, ZPRIM Changes its Magazine Advertisements to Omit GIPS-Required Performance Return Information Which Would Have Revealed ZPRIM's Negative Performance Returns

ZPRIM began running magazine advertisements in 2006.⁷⁰ The original magazine template included year-by-year performance returns, back to 2001, and period-to-date information.⁷¹ As discussed in Section II.B(2) above, this is the information the GIPS advertising guidelines required. Advertisements in *SmartMoney* in January and April 2008 reported year-by-year performance returns, period-to-date returns, and compounded returns for ZPRIM's SCV Composite.⁷² ZPRIM also ran advertisements in *Kiplinger* in January and February 2008, which both reported performance returns for the SCV Composite that complied with the GIPS advertising guidelines.⁷³

However, ZPRIM changed its magazine advertisements to omit the GIPS-required information commencing with the October 2008 magazine advertisement at issue in this case. Specifically, in October, November, and December 2008, ZPRIM ran advertisements in *SmartMoney*, reporting its performance returns using annualized returns instead of year-by-year

⁶⁸ *Id.* at 15 n. 12.

⁶⁹ *Id.* at 16.

⁷⁰ *Id.* at 23.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

returns as ZPRIM had used in the past.⁷⁴ Each of these advertisements included a statement that, “ZPR Investment Management claims compliance with the Global Investment Performance Standards (GIPS®).”⁷⁵ It is undisputed, however, that none of these advertisements contained the performance returns for the periods GIPS requires. As the Law Judge correctly explained in finding the advertisements did not comply with the GIPS advertising guidelines, and as the Respondents admitted, none of the October, November, or December 2008 *SmartMoney* advertisements provided returns through the same period as any GIPS-Compliant Presentations for the SCV Composite, nor did any provide period-to-date returns.⁷⁶ Nor did any of these advertisements include one, three, or five-year annualized returns GIPS requires⁷⁷

Instead, the advertisements only showed performance returns indicating ZPRIM had outperformed its index benchmarks.⁷⁸ Had ZPRIM followed the GIPS advertising guidelines and reported performance returns for the periods GIPS requires, the advertisements would all have shown that ZPRIM’s SCV Composite “significantly underperformed” the Russell 2000 Index.⁷⁹ Zavanelli conceded that had the 2008 advertisements complied with GIPS, they would have shown that the SCV Composite’s one-year return was underperforming its Russell 2000

⁷⁴ *Id.* at 23-25.

⁷⁵ *Id.*, citing DX 5-8 and DX 25 at 42.

⁷⁶ *Id.*

⁷⁷ *Id.* at 23-24.

⁷⁸ *Id.*

⁷⁹ *Id.* at 24.

Index benchmark.⁸⁰ Instead, ZPRIM's non-compliant advertisements showed the SCV Composite was over-performing the index.

Zavanelli initially maintained that he did not personally approve or know about the changes in format until after the advertisements had run.⁸¹ However, Zavanelli conceded at the hearing that ZPRIM changed its advertising format to exclude annual returns after knowing that ZPRIM's performance at the time was poorer than its benchmarks.⁸² Bauchle expressed concern to Zavanelli about the advertisements' failure to comply with GIPS in August or September 2008, when Zavanelli wanted to change the format, but the advertisements ran anyway at Zavanelli's direction.⁸³

**e. ZPRIM Continues False Claims of GIPS Compliance
in 2011 Magazine Advertisements**

The Respondents do not dispute the Law Judge's finding that ZPRIM's February, March, and May 2011 magazine advertisements included statements claiming ZPRIM complied with GIPS, but the advertisements failed to comply with the GIPS advertising guidelines.⁸⁴ Specifically, the advertisements omitted performance return periods GIPS requires.⁸⁵ The Law Judge correctly found that in addition to the GIPS compliance failures in the 2008 and 2011 advertisements alleged in the OIP, the Division established at the hearing that 20 of the 21

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.* at 25.

⁸⁴ *Id.* at 27.

⁸⁵ *Id.*

advertisements ZPRIM published between January 2008 and April 2010, all making claims of GIPS compliance, failed to comply with GIPS.⁸⁶

f. ZPRIM Intentionally Fails to Send Ashland the Magazine Advertisements Because They Do Not Comply with GIPS

The Law Judge correctly found ZPRIM intentionally failed to send Ashland the advertisements at issue in this case, which advertisements did not comply with the GIPS advertising guidelines.⁸⁷ The Law Judge concluded that Zavanelli directed Bauchle to stop sending advertising to Ashland and to provide Ashland a plausible, but false, explanation.⁸⁸ Bauchle then falsely told Feliz ZPRIM did not intend to run advertisements after January 2008.⁸⁹

Had Ashland been shown ZPRIM's magazine advertisements, Ashland would have discussed the problems in the advertisements and, if ZPRIM had corrected those problems, it could have continued to claim GIPS compliance.⁹⁰ However, this never happened.⁹¹ Instead, ZPRIM kept the advertisements at issue in this case from Ashland, and did not correct the problems with the advertisements.

g. ZPRIM's Investment Report Newsletters do not Comply with GIPS

ZPRIM sent its monthly investment report newsletters to clients, academics, institutional investors, journalists, family members, and friends, among others.⁹² Zavanelli wrote the

⁸⁶ *Id.* at 28-30.

⁸⁷ *Id.* at 17 n. 14.

⁸⁸ *Id.*

⁸⁹ *Id.* at 17 n. 14.

⁹⁰ *Id.* at 17.

⁹¹ *Id.* at 16-17.

⁹² *Id.* at 30.

majority of the content for the newsletters.⁹³ ZPRIM sent April and December 2009 investment report newsletters to its distribution list which reported performance returns, stated ZPRIM is a GIPS-compliant firm, and failed to include the performance return information GIPS requires.⁹⁴ Zavaneli conceded that these newsletters did not comply with the GIPS advertising guidelines.⁹⁵

h. Ashland Resigns Because ZPRIM Will Not Take its Advice on GIPS Compliance Issues

In November 2008, Ashland sent ZPRIM an email attaching a list of comments generated from its review of ZPRIM's website, and raised concerns that the investment report newsletters on the website claimed GIPS compliance without including all of the information required by the GIPS advertising guidelines.⁹⁶ Ashland suggested that if ZPRIM decided to continue to claim GIPS compliance in the investment report newsletters, ZPRIM would need to either include the required information from the GIPS advertising guidelines or attach a copy of its GIPS compliant presentations for the composites.⁹⁷ Ashland repeated these same concerns to ZPRIM concerning the firm's June 2009 newsletter.⁹⁸

In late 2009, Ashland told Bauchle to send ZPRIM's GIPS-Compliant Presentation to everyone on the monthly investment report newsletter distribution list, and Bauchle did this.⁹⁹

⁹³ *Id.*

⁹⁴ *Id.* at 30-31.

⁹⁵ *Id.*

⁹⁶ *Id.* at 17.

⁹⁷ *Id.*

⁹⁸ *Id.* at 17-18.

⁹⁹ *Id.* at 18.

Zavanelli learned this information was shared with investors, and was upset because he did not want to reveal ZPRIM's asset levels.¹⁰⁰

At the end of 2009, Feliz told Zavanelli that ZPRIM's newsletters should be considered advertisements and that ZPRIM should either follow the advertising guidelines or attach a GIPS-Compliant Presentation to provide the GIPS-required information to investors.¹⁰¹ Feliz and a partner at Ashland spoke with Zavanelli again in March or April 2010, and subsequently sent ZPRIM a letter advising the firm should either cease claiming GIPS compliance in its newsletters or follow the GIPS advertising guidelines.¹⁰²

When ZPRIM continued to issue investment report newsletters while failing to follow Ashland's advice, Ashland resigned as ZPRIM's GIPS verifier. On July 9, 2010, Ashland sent ZPRIM a letter terminating the relationship as ZPRIM's GIPS verifier, citing Ashland's inability to reach a "necessary level of comfort which would allow [Ashland] to continue to attest to the firm's claim of GIPS compliance."¹⁰³ Feliz testified that she has been involved with over 400 clients during her tenure at Ashland, and ZPRIM was the only client she could recall Ashland terminating.¹⁰⁴ Ashland completed its verification of ZPRIM's GIPS compliance through the final quarter of 2009.¹⁰⁵ Though Ashland terminated its relationship with ZPRIM in mid-2010, it

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.* at 19.

¹⁰³ *Id.*, citing DX 36.

¹⁰⁴ *Id.* at 20.

¹⁰⁵ *Id.*

did not perform any verification services for periods in 2010.¹⁰⁶ Ashland retained a new verifier, Alpha Performance Verification Services, in November or December 2010.¹⁰⁷

4. The Law Judge's Findings Concerning the Morningstar Reports

ZPRIM began providing information to Morningstar in approximately 1998 to attract institutional investor clients.¹⁰⁸ In 2005, Morningstar expanded access to its database beyond institutional investors.¹⁰⁹ Bauchle provided information to Morningstar for the reports,¹¹⁰ and ZPRIM sent the reports to some prospective clients as early as 2008.¹¹¹

The Law Judge found ZPRIM's September 30, 2010 and March 31, 2011 Morningstar reports both falsely reported there was no Commission investigation pending as a result of ZPRIM's misrepresentations.¹¹² Zavanelli admitted ZPRIM was aware of the Commission investigation on August 16, 2010, and minutes from an August 30, 2010 board meeting show ZPRIM had received a letter from the Commission, retained counsel, and was gathering documents to respond to the Commission's inquiry.¹¹³ However, ZPRIM caused the Morningstar reports to falsely state there was no investigation.

The Law Judge also correctly found ZPRIM's September 30, 2010 Morningstar report falsely stated ZPRIM's performance returns had been verified "through the present" by Ashland

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 31.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.* at 32-33.

¹¹² *Id.* at 49.

¹¹³ *Id.* at 33-34.

when, in truth, Ashland had resigned as the firm's verifier on July 9, 2010, and had made clear its verification extended only through December 31, 2009.¹¹⁴ The Respondents do not dispute this finding, but argue that ZPRIM's new verifier, Alpha, verified ZPRIM for calendar year 2012.¹¹⁵ Even if this was supported by the record, it is irrelevant to the Law Judge's findings concerning the September 30, 2010 Morningstar report.

The Law Judge found ZPRIM primarily liable for these misrepresentations in the Morningstar reports and found Zavanelli aided and abetted and caused the violations.

5. The Law Judge's Findings Concerning Zavanelli's Credibility

The Law Judge found Zavanelli provided inconsistent or not credible testimony on myriad issues in the proceedings. For example, the Law Judge found Zavanelli's testimony inconsistent, confusing, and/or evasive concerning the following issues, among others:

- Zavanelli's level of responsibility for GIPS compliance.¹¹⁶
- ZPRIM not sending the advertisements at issue to Ashland.¹¹⁷
- The resignation of Ashland as ZPRIM's GIPS verifier.¹¹⁸
- The creation of ZPRIM's fall 2008 advertisements.¹¹⁹
- Whether investors could access the Morningstar report.¹²⁰

¹¹⁴ *Id.* at 49.

¹¹⁵ Respondents' Brief at 20.

¹¹⁶ *Id.* at 13.

¹¹⁷ *Id.* at 16.

¹¹⁸ *Id.* at 19.

¹¹⁹ *Id.* at 25-26.

¹²⁰ *Id.* at 32.

- Zavanelli’s use of an online “ZPR Portal” to stymie Commission scrutiny of his communications.¹²¹
- Zavanelli’s knowledge of the Commission’s investigation and the Morningstar reports stating there was no Commission investigation.¹²²

The Law Judge also found Zavanelli’s demeanor, attitude, and overall presentation were entirely consistent with the finding that he, and therefore ZPRIM, acted willfully and with scienter.¹²³ More specifically, the Law Judge correctly found Zavanelli was disrespectful, his testimony was “replete with instances of combativeness, evasion, and non-responsive answers,”¹²⁴ and continued to misbehave despite warnings from the Law Judge.¹²⁵

6. The Law Judge’s Conclusions Concerning Sanctions

Based on the Respondents’ repeated violations of the federal securities laws, the Law Judge sanctioned ZPRIM by imposing a censure, cease-and-desist order, and a civil penalty of \$250,000, and Zavanalli by imposing a permanent bar from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and

¹²¹ *Id.* at 38-40.

¹²² *Id.* at 34.

¹²³ *Id.* at 43-45, citing *In re Columbia Securities Litig.*, 155 F.R.D. 466, 479 (S.D.N.Y. 1994) (evaluating scienter “generally requires examination of a witness’s demeanor and credibility”); *SEC v. Elliot*, No. 09-cv-7594, 2012 WL 2161647, at *2 (S.D.N.Y. June 12, 2012) (demeanor bolstered finding of scienter); *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 373 (S.D.N.Y. 1998) (demeanor relevant to evaluating likelihood of committing future violations).

¹²⁴ *Id.* at 43.

¹²⁵ *Id.* at 44-45.

nationally recognized statistical rating organization, a cease-and-desist order, and first and second tier civil penalties against him totaling \$660,000.

III. STANDARD OF REVIEW

Rule 411(a) of the Commission's Rules of Practice provides that in reviewing initial decisions, the Commission may "make any findings or conclusions that in its judgment are proper and on the basis of the record." The Commission may therefore undertake an independent review of the record in evaluating ZPRIM and Zavanelli's challenge to the Initial Decision.

Many of the Law Judge's findings of fact are based on credibility determinations. These determinations are entitled to substantial deference and should only be overturned if there is "substantial evidence" for doing so.¹²⁶

IV. LEGAL ARGUMENT

ZPRIM and Zavanelli present a number of challenges to the Law Judge's Initial Decision. As an initial matter, they assert the Law Judge erred in finding they violated the Advisers Act. They also argue the Law Judge's sanctions are excessive. For all the reasons set forth below, there is no merit to either of these challenges.

¹²⁶ *Universal Camera Corp. v. NLRB*, 340 U.S. 474 (1951) (credibility determinations of initial decision maker entitled to great weight and deference since they are based on hearing testimony and observing demeanor of witnesses); *Anthony Tricarico*, 51 S.E.C. 457, 461 (1993) (credibility determinations by finder of fact can be overcome only when the record contains substantial evidence for doing so); *Jack Schaefer*, 46 S.E.C. 59, n. 5 (1976) ("The administrative law judge saw and heard the witnesses. We did not. Hence we give great weight to [her] conclusions about the credibility and the probative force of the testimony."); *U.S. v. Raddatz*, 447 U.S. 667 (1980) (De novo review of record on appeal does not require de novo review of credibility findings.).

**A. Violations of Sections 206(1), 206(2), and 206(4)
Of the Investment Advisers Act**

There is no merit to the Respondents' argument that the Law Judge's determinations that ZPRIM violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Zavanelli aided and abetted those violations are predicated on legal errors and clearly erroneous determinations of fact. As discussed below, the Law Judge's careful findings are consistent with relevant law and fully supported by the record in this case.

The Respondents do not dispute the Law Judge's findings as to what the Division must prove to succeed on these claims. Under sections 206(1), (2), and (4) of the Advisers Act, the Division must prove ZPRIM: (1) was an investment adviser; (2) that engaged in fraudulent activities; (3) by jurisdictional means; and (4) breached its fiduciary duty by making false or misleading statements or omissions of material fact at least negligently.¹²⁷ To establish a violation of Section 206(1), the Division must also prove that ZPRIM and Zavanelli acted with scienter.¹²⁸ As with Section 206(2), which prohibits engaging in "any transaction, practice, or course of business which operates as a fraud or deceit," scienter need not be proven under Section 206(4).¹²⁹ Where a respondent's misrepresentations violate Sections 206(1) and 206(2), they also violate Section 206(4).¹³⁰

¹²⁷ Initial Decision at 46, citing *SEC v. Gotchey*, 981 F.2d 1251 (4th Cir. 1992); *SEC v. Merrill Scott & Assoc., Ltd.*, 505 F. Supp. 2d 1193 (D. Utah 2007); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92 (1963)).

¹²⁸ Initial Decision at 46, citing *SEC v. Steadman*, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992).

¹²⁹ Initial Decision at 46, citing 15 U.S.C. § 80b-6(2), (4); *Capital Gains Research Bureau*, 375 U.S. at 195.

¹³⁰ Initial Decision at 46, citing *SEC v. Blavin*, 557 F. Supp. 1304, 1315 (D. Mich. 1983) (Section 206(4)'s standard is looser than that of 206(1), and so liability under 206(1) also creates liability under 206(4)).

The Respondents also do not dispute the Law Judges's findings that the Division proved the first and third elements, that ZPRIM was an investment adviser and the Respondents engaged in interstate commerce.¹³¹ As set forth below, the Law Judge's conclusions that the Division proved the remaining elements of the claims are correct and supported by substantial evidence.

On appeal, the Respondents present essentially the same meritless arguments the Law Judge rejected. Specifically, they claim the Law Judge made four erroneous conclusions in finding violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act: (1) ZPRIM's misrepresentations concerning GIPS compliance in the six magazine and two newsletter advertisements were misleading;¹³² (2) ZPRIM's misrepresentations in the magazine and newsletters were material;¹³³ (3) the Respondents acted with scienter in connection with the misrepresentations and omissions in the magazine and newsletter advertisements;¹³⁴ and (4) the Respondents acted with scienter in connection with the false statement in the March 2011 Morningstar report that there was no pending Commission investigation.¹³⁵ Each of these arguments relies on an incorrect reading of the case law and is contrary to the record in this case.

¹³¹ Initial Decision at 47

¹³² Respondents' Brief at 28-30.

¹³³ Respondents' Brief at 33.

¹³⁴ *Id.* at 30-31.

¹³⁵ *Id.* at 31-33.

1. The Law Judge Correctly Held ZPRIM's Claims of GIPS Compliance in Magazine and Newsletter Advertisements Were Material, Misleading Representations¹³⁶

As the Law Judge noted, ZPRIM and Zavanelli admitted in their Answer to the OIP that the six magazine advertisements from October, November, and December 2008, and February and May 2011, stated ZPRIM claimed GIPS compliance, and yet these advertisements failed to comply with GIPS advertising guidelines.¹³⁷ ZPRIM's April and December 2009 investment report newsletter advertisements made these same misrepresentations. The Respondents maintained below that the misrepresentations in the advertisements were not material.¹³⁸ The Law Judge rejected this argument, correctly finding ZPRIM's misrepresentations of GIPS compliance were material.¹³⁹

The Law Judge correctly found the Division proved that ZPRIM's misrepresentations about GIPS compliance in each of the magazine and newsletter advertisements was material.¹⁴⁰ The standard of materiality under Section 206 is whether a reasonable investor would have considered the information important in deciding whether to invest.¹⁴¹ Materiality is proved by showing a "substantial likelihood that the disclosure of the omitted fact would have been viewed

¹³⁶ We address the first two arguments, concerning materiality and misrepresentations, together to avoid repetition.

¹³⁷ Initial Decision at 3.

¹³⁸ *Id.*

¹³⁹ *Id.* at 50-56.

¹⁴⁰ Initial Decision at 56.

¹⁴¹ See *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”¹⁴²

As to the fall 2008 advertisements, the Law Judge found that as a general matter, “misrepresentations overstating [Respondents’] performance as against market benchmarks [is] material.”¹⁴³ Further, Zavanelli conceded that knowledge that a firm’s composites did not meet its benchmarks is important to investors.¹⁴⁴ Thus, ZPRIM’s fall 2008 advertisements which omitted GIPS-required information that would have disclosed ZPRIM was underperforming its index benchmarks is clearly material.

The Law Judge’s more specific finding that false claims of GIPS compliance are material is supported by the evidence and law. As Zavanelli and Bauchle acknowledged in their testimony, GIPS compliance is a threshold factor for institutional investors considering money managers.¹⁴⁵ Institutional investors will not consider money managers that are not GIPS compliant, and investors know that firms that choose to make such claims must undertake additional, mandatory disclosure obligations.¹⁴⁶ The Law Judge correctly concluded that “it stands to reason that firms like ZPRIM include claims of GIPS compliance in their advertisements because, to institutional investors, GIPS compliance is important in deciding

¹⁴² *SEC v. Ginsburg*, 362 F.3d 1292, 1302 (11th Cir. 2004) (quoting *TSC Indus.*, 426 U.S. at 449 (1976)).

¹⁴³ Initial Decision at 56, citing *Seaboard Investment Advisers, Inc.*, 54 S.E.C. 1111, 1118 (2001).

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 56.

¹⁴⁶ *Id.*

whether to invest.”¹⁴⁷ Indeed, Bauchle testified ZPRIM began claiming GIPS compliance after learning it helped attract institutional investors, and Zavanelli conceded at the hearing that claiming GIPS compliance helped attract institutional investors.¹⁴⁸

As the District Court in *Riggs Investment Management Corp. v. Columbia Partners, LLC* explained when considering a similar situation, “compliance with AIMR [GIPS’ predecessor] has importance for a firm’s reputation.”¹⁴⁹ *Riggs* held that a “[v]iolation of AIMR does not, in and of itself, mean that the [law] is violated. But to advertise oneself as meeting such an important industry standard while knowingly being out of compliance is false advertising.”¹⁵⁰ Applying *Riggs*, the Law Judge correctly found that the manner in which ZPRIM failed to comply with GIPS further supported the conclusion that the advertisements contained material misrepresentations.¹⁵¹ In the fall 2008 advertisements, ZPRIM failed to disclose underperformance of one of its index benchmarks, in addition to ZPRIM’s negative performance returns.¹⁵² The Law Judge found that by selecting performance return periods other than those GIPS requires, ZPRIM was able to report strong returns — double and even triple the returns of the SCV Composite’s benchmarks.¹⁵³ Had ZPRIM included the performance return periods GIPS requires, the advertisements would have shown returns for the SCV Composite that were

¹⁴⁷ Initial Decision at 56.

¹⁴⁸ *Id.* at 51.

¹⁴⁹ 966 F. Supp. 1250, 1262 (D.D.C. 1997).

¹⁵⁰ *Id.* at 1268.

¹⁵¹ Initial Decision at 56.

¹⁵² *Id.* at 57.

¹⁵³ *Id.*

not only negative, but also underperforming one of the SCV Composite's benchmarks, the Russell 2000 index.¹⁵⁴

The Law Judge correctly concluded that investors would want to know that the returns reported created a false impression of the firm's recent performance "because investors routinely consider an adviser's past investment performance and attractiveness to other investors when making investment decisions."¹⁵⁵ The Law Judge also properly concluded that prohibiting firms from reporting performance in incomparable terms to reflect the firm in the best light possible, as determined by the firm, is exactly the goal that GIPS reporting strives for, and investors expect that a firm claiming GIPS compliance in an advertisement will abide by GIPS' terms.¹⁵⁶

As the Law Judge correctly explained, *Riggs* provides insight into why these claims of GIPS compliance in advertisements that failed to comply with GIPS were material. The defendants in *Riggs* falsely claimed compliance with AIMR in advertisements in which they linked performance returns with those from an adviser's prior partners, hoping to convince investors that the firm's track record was more substantial than it was.¹⁵⁷ The court in *Riggs* remarked, "a three-to-five year performance record is a prerequisite to an investment manager receiving his recommendation to a client. That such advertising is material in effect cannot be

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*, citing *Warwick Capital Mgmt., Inc.*, 92 SEC Docket at 1423.

¹⁵⁶ *Id.*

¹⁵⁷ 966 F. Supp. at 1262.

doubted.”¹⁵⁸ So too, the Law Judge properly concluded, ZPRIM’s failure to report its composite’s underperformance while claiming GIPS compliance was material.¹⁵⁹

The Law Judge also properly credited Feliz’s uncontroverted testimony that claims of GIPS compliance provide comfort to investors, when comparing money managers, “that the presentations they’re looking at are fairly presented,” and that claims of GIPS compliance create expectations of uniformity and comparability, in addition to integrity of return presentations.¹⁶⁰ The Law Judge also properly found Zavanelli demonstrated how compliance with GIPS advertising guidelines, or lack thereof, materially affected ZPRIM’s portrayal in advertisements, and thus comparability, in an article Zavanelli authored for ZPRIM’s December 2009 investment report.¹⁶¹ In the article, Zavanelli remarked that asset weighting portfolios, which is required for GIPS reporting, did not reflect ZPRIM’s success.¹⁶²

Thus, after thoughtful consideration of the evidence and law, the Law Judge concluded that ZPRIM’s claims of GIPS compliance were material. The Respondents offer no legal support to the contrary and instead repeat the same argument the Law Judge correctly rejected below – namely, that investors could have discovered the truth and obtained the GIPS-required performance returns omitted from the advertisements by contacting ZPRIM or visiting ZPRIM’s website.¹⁶³ As the Law Judge held in rejecting this argument, the Respondents’ argument

¹⁵⁸ *Id.* at 1269.

¹⁵⁹ Initial Decision at 57.

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ Respondents’ Brief at 14-15, 28-30.

“misses the point.”¹⁶⁴ The issue is whether the advertisements were materially misleading, not whether investors could have obtained follow-up materials that disclosed the truth.¹⁶⁵ The advertisements themselves were still materially misleading.¹⁶⁶

Accordingly, there is no merit to the Respondents’ contention that the Law Judge erred in finding the magazine and newsletter advertisements contained material misrepresentations.

2. The Law Judge Correctly Held the Respondents Acted with Scienter in Connection with the Misrepresentations in the Magazine and Newsletter Advertisements

The Respondents also wrongly argue the Law Judge erred in finding ZPRIM, through Zavanelli, acted with scienter in connection with the magazine and newsletter advertisements.¹⁶⁷ They acknowledge that scienter may be based on severe recklessness as well as an intent to deceive, manipulate, or defraud.¹⁶⁸ They do not challenge the Law Judge’s findings concerning recklessness, negligence, or an investment advisor having an affirmative duty of utmost good faith and full and fair disclosure of all material facts.¹⁶⁹

Instead, the Respondents take the unsupported position that there was no danger of misleading a potential investor because the GIPS-required information ZPRIM omitted from the magazine and newsletter advertisements was available if clients requested or searched for it on ZPRIM’s website. They also argue, irrelevantly, the performance return figures ZPRIM did

¹⁶⁴ Initial Decision at 58.

¹⁶⁵ Initial Decision at 58.

¹⁶⁶ *Id.*

¹⁶⁷ Respondents’ Brief at 30-31.

¹⁶⁸ *Id.* See also Initial Decision at 50.

¹⁶⁹ Initial Decision at 50.

include in the advertisements were correct.¹⁷⁰ These arguments do not address the issue presented in this matter, that the advertisements were misleading for making false claims of GIPS compliance. Accordingly, the Law Judge properly rejected both of these arguments.¹⁷¹

The Respondents also ignore the Law Judge's finding that even if the performance returns in the advertisements were accurate and true, this would not preclude a finding of liability where the advertisement was "deceptive and misleading in [its] overall effect."¹⁷² The Law Judge correctly found ZPRIM's claim of GIPS compliance, without following the GIPS guidelines, made the advertisements and newsletters misleading. He further found ZPRIM knew clients and prospective clients would have understood that the GIPS-related statements in ZPRIM's advertisements were claims that the advertisements themselves were GIPS compliant.¹⁷³

The Law Judge's conclusion that the Respondents acted with scienter is supported by numerous findings:

- Zavanelli familiarized himself with the GIPS guidelines in 2006 when ZPRIM first began claiming GIPS compliance, and he maintained that familiarity going forward.¹⁷⁴
- Zavanelli testified he was ultimately responsible for the creation and placement of all advertisements and their GIPS-compliant claims until October 2011.¹⁷⁵

¹⁷⁰ Respondents' Brief at 31.

¹⁷¹ Initial Decision at 49.

¹⁷² Initial Decision at 49, citing *SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1106-07 (9th Cir. 1977).

¹⁷³ Initial Decision at 49.

¹⁷⁴ *Id.* at 54.

¹⁷⁵ *Id.* at 50-51.

- Zavanelli authorized the six magazine advertisements and two newsletters at issue in this case, and he authorized the placement of GIPS-compliance claims in those particular advertisements.¹⁷⁶
- ZPRIM included claims of GIPS compliance in the magazine and newsletter advertisements because it believed it would help attract institutional investors.¹⁷⁷
- Zavanelli testified that he was, at the very least, aware that claiming GIPS would help ZPRIM attract institutional investors.¹⁷⁸
- The October 2008 advertisement was the first instance, at least in 2008, of ZPRIM excluding the year-by-year returns or period-to-date returns GIPS requires.¹⁷⁹
- Had ZPRIM followed its previous advertisement format, it would have shown that ZPRIM had negative returns and was underperforming its Russell 2000 Index benchmark.¹⁸⁰
- Avoiding disclosure of the negative returns and negative benchmark comparison was the principal reason for changing the format of the advertisements in 2008, so that the fall 2008 advertisements would show only favorable comparisons.¹⁸¹
- Zavanelli conceded that ZPRIM changed its advertising format in 2008 to exclude annual returns after knowing ZPRIM's performance at the time was poorer than its benchmarks.¹⁸²
- Zavanelli admitted he authorized the addition of the claim of GIPS compliance in the 2011 magazine advertisements, even though the performance return charts in the advertisements omitted GIPS-required performance returns and could not be altered to comply with the requirements in the GIPS advertising guidelines.¹⁸³

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.* at 24.

¹⁸³ *Id.* at 50-51.

- When Zavanelli approved the 2011 advertisements, he, and therefore ZPRIM, was unquestionably aware of the GIPS advertising guidelines' requirements to include specific performance return periods because he had previously received warnings from Ashland and the Commission that advertisements claiming GIPS compliance must include the performance returns GIPS requires.¹⁸⁴ Yet Zavanelli ignored this advice.¹⁸⁵
- By the time of the 2011 advertisements, ZPRIM had represented in a letter to Commission staff that it would take measures to correct these problems in its advertisements.¹⁸⁶
- When Zavanelli approved the 2011 advertisements, he had heard from Bauchle that the October, November, and December 2008 advertisements lacked required one, three, and five-year returns, and were thus not GIPS compliant.¹⁸⁷
- Zavanelli created or directed the investment report newsletters' content, and he was responsible for including the claims of GIPS compliance in those investment report newsletters as well.¹⁸⁸
- Ashland told ZPRIM numerous times that the newsletters were advertisements and thus needed to comply with the GIPS advertising guidelines, but Zavanelli disregarded this advice.¹⁸⁹
- When Bauchle heeded Ashland's advice to send newsletter recipients a GIPS-Compliant Presentation with the GIPS-required performance return periods, Zavanelli disagreed with Bauchle and directed him to never again send this information.¹⁹⁰
- Zavanelli's awareness that the newsletters claiming GIPS compliance needed to include the GIPS-required performance returns was further illustrated in his December 2009 newsletter, where he wrote about this issue.

These findings clearly support the Law Judge's finding that Zavanelli, and thus ZPRIM, acted with scienter. The Respondents' arguments to the contrary center primarily on their claim

¹⁸⁴ *Id.* at 54.

¹⁸⁵ *Id.* at 54.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 54.

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

that the Law Judge erred in finding Zavanelli's testimony not credible and his version of events unlikely. The Respondents ignore the Law Judge's finding, supported by overwhelming evidence and detailed citations to the hearing record, that "Zavanelli's demeanor, attitude, and overall presentation are entirely consistent with the finding that he, and therefore ZPRIM, acted willfully and with scienter."¹⁹¹ Instead, they argue the Law Judge erred in failing to credit Zavanelli's testimony that he did not see the fall 2008 advertisements prior to publication, did not create the format for the advertisements, directed Bauchle to follow the earlier format which included the GIPS-required performance returns, Ashland drafted the footnote claiming GIPS compliance, and Ashland and the Commission did not advise Zavanelli of GIPS deficiencies.¹⁹²

The Law Judge considered and correctly rejected these arguments, crediting Bauchle's testimony and finding Zavanelli knew that the fall 2008 advertisements were not GIPS compliant.¹⁹³ In a thoughtful discussion of the evidence, the Law Judge explained his finding that Zavanelli's version of events was unlikely, including: (1) it would be uncharacteristic of Zavanelli to grant *carte blanche* authority to others to reformat the advertisements without checking them; (2) Zavanelli admitted his involvement and final authority on all advertisements; and (3) Zavanelli was protective of ZPRIM's brand and reluctant to release information that might case ZPRIM in an unfavorable light.¹⁹⁴

The Law Judge also correctly rejected the Respondents' argument on appeal, that in 2008 Bauchle lacked adequate knowledge of GIPS, was unaware of GIPS compliance concerns, and

¹⁹¹ Initial Decision at 45.

¹⁹² Respondents' Brief at 23.

¹⁹³ Initial Decision at 51.

¹⁹⁴ *Id.* at 51-52.

did not express any concerns to Zavanelli prior to publishing the October 2008 advertisement that the advertisements were not GIPS compliant.¹⁹⁵ The Law Judge found Zavanelli's arguments unsupported, and credited Bauchle's testimony that he expressed concerns to Zavanelli that the new format of the advertisement did not include GIPS-required performance returns.¹⁹⁶ The Law Judge's finding was supported by Bauchle's testimony as well a September 2008 email from Bauchle to ZPRIM's compliance officer, Ruth Ann Fay, raising these same concerns.¹⁹⁷ Further, Jean Cabot, the Securities and Exchange Commission examinations manager who conducted the 2009 examination of ZPRIM, testified that during the Commission's 2009 examination, both Bauchle and Fay told her they knew the advertisements were not GIPS-compliant, but the advertisements ran anyway at Zavanelli's direction.¹⁹⁸ The Law Judge also found Bauchle's testimony was bolstered by the fact that it paralleled the dispute Ashland had with Zavanelli where Zavanelli was reluctant to include GIPS-required information in the investment report newsletters,¹⁹⁹ and Zavanelli's version of events was inconsistent with his investigative testimony.²⁰⁰

The Respondents' argument that the Law Judge erred in finding Ashland did not draft the footnote in the advertisements stating ZPRIM complied with GIPS is both unsupported and

¹⁹⁵ Respondents' Brief at 24-25.

¹⁹⁶ Initial Decision at 25, 52-53.

¹⁹⁷ *Id.* at 25.

¹⁹⁸ *Id.* at 25.

¹⁹⁹ Initial Decision at 52-53.

²⁰⁰ *Id.* at 53.

irrelevant.²⁰¹ The Law Judge relied on testimony from Feliz that Ashland did not write footnotes, and rejected Zavanelli's testimony that Ashland drafted the footnote ZPRIM included in the advertisements.²⁰² As the Law Judge correctly found, the language in the footnote for claiming GIPS compliance is standardized in the GIPS advertising guidelines, and it is unlikely Ashland would have advised ZPRIM how to craft the footnote other than to direct ZPRIM to the standardized language in the guidelines.²⁰³ Further, the issue is whether ZPRIM made a misrepresentation by falsely claiming GIPS compliance in the footnote, and not whether the footnote correctly tracked the GIPS guidelines language for doing so. As the Respondents conceded, the advertisements did not comply with the GIPS advertising guidelines, and Zavanelli made the decision to include the footnote claiming GIPS compliance in the advertisements anyway. Further, regardless of whether Ashland helped draft the initial footnote language for a prior advertisement, it is undisputed that ZPRIM failed to send the advertisements at issue to Ashland for their review. In fact, the Law Judge found the Respondents intentionally failed to send the advertisements to Ashland because they knew the advertisements were not GIPS-compliant.

The Respondents' argument that the Law Judge erred in finding Ashland notified ZPRIM of GIPS deficiencies²⁰⁴ ignores the Law Judge's detailed findings and credibility determinations. The Law Judge found Feliz's testimony credible that she told ZPRIM its advertisement did not

²⁰¹ Respondents' Brief at 10-11.

²⁰² Initial Decision at 14 and n.11.

²⁰³ *Id.*

²⁰⁴ Respondents' Brief at 11-12.

comply with the GIPS advertising guidelines,²⁰⁵ and Zavanelli's version of events confusing, inconsistent, and evasive.²⁰⁶ The Respondents' argument that the Court should credit Zavanelli's version of events, that he did not know about the Ashland letter concerning the GIPS deficiency with ZPRIM's newsletter²⁰⁷ ignores the Law Judge's findings and citations to the record evidence. The Law Judge rejected Zavanelli's testimony that he did not see the letter until 2011, finding Zavanelli gave different versions of events during the investigation and at the hearing, and also discussed Ashland's telephone discussion with Zavanelli about these same issues.²⁰⁸ The Law Judge's detailed findings and citations to the record support his findings and the Commission should not disturb the Law Judge's credibility findings concerning Feliz and Zavanelli.

Similarly, the Respondents' argument that the Commission's 2009 Deficiency Letter to ZPRIM concerned ZPRIM not following the 2005 GIPS advertising guidelines, and ZPRIM's subsequent failures concerned the updated 2010 GIPS advertising guidelines is irrelevant.²⁰⁹ The issue is that Ashland and the Commission told ZPRIM it needed to follow the GIPS advertising guidelines, and ZPRIM promised to follow the guidelines but then chose not to.

Accordingly, there is no merit to the Respondents' contention that the Law Judge erred in finding they acted with scienter by making false claims of GIPS compliance in the magazine and newsletter advertisements.

²⁰⁵ Initial Decision at 15 n.12

²⁰⁶ *Id.* at 16-18.

²⁰⁷ Respondents' Brief at 18-19.

²⁰⁸ Initial Decision at 19.

²⁰⁹ Respondents' Brief at 21-22.

3. The Law Judge Correctly Held ZPRIM Acted with Scierter by Falsely Stating There Was No Commission Investigation in ZPRIM's March 2011 Morningstar Report

The Respondents also wrongly argue the Law Judge erred in finding ZPRIM, through Zavanelli, acted with scierter by claiming in the March 31, 2011 Morningstar report that the Commission was not investigating ZPRIM when, in fact, it was.²¹⁰ The Respondents claim the Law Judge erroneously found scierter because Bauchle, who was responsible for the reports, testified he did not believe ZPRIM was required to disclose the investigation until the Commission filed a case.²¹¹ This ignores the Law Judge's findings that Bauchle admitted he knew in October 2010 that a Commission investigation was pending.²¹² The Law Judge considered the same arguments Respondents make on appeal. He correctly found, based on Bauchle's explanation of events and the evidence presented about Zavanelli's efforts to downplay the investigation at ZPRIM, that the false statement in the Morningstar report was the result of willful blindness, and thus constituted recklessness.²¹³

The Respondents' argument that Morningstar subsequently instructed ZPRIM that they could claim there was no investigation until charges were filed is irrelevant.²¹⁴ As the Respondents' concede, ZPRIM received these instructions well after the March 2011 Morningstar report was published.²¹⁵ Therefore, they have no bearing on the Law Judge's scierter finding.

²¹⁰ Respondents' Brief at 30-31.

²¹¹ Respondents' Brief at 31-32.

²¹² Initial Decision at 55-56.

²¹³ *Id.* at 56.

²¹⁴ Respondents' Brief at 32.

²¹⁵ *Id.*

The Respondents' argument that the Law Judge's scienter finding was erroneous because the general public did not have access to the Morningstar report database is flawed.²¹⁶ As the Law Judge correctly found in rejecting this argument, there is no requirement that advertisements be widely publicized, or be publicized beyond a specific group.²¹⁷ In fact, multiple courts have found violations of Advisers Act Rule 206(4)-1(a)(5) for misrepresentations by investment advisers in subscription newsletters.²¹⁸

Accordingly, there is no merit to the Respondents' contention that the Law Judge erred in finding they acted with scienter by falsely claiming there was no pending Commission investigation in the March 2011 Morningstar Report.

B. Sanctions

As for the Law Judge's sanctions findings, the Respondents only appeal the associational bar imposed against Zavanelli and the imposition of second tier penalties.

1. The Law Judge Correctly Imposed an Associational Bar Against Zavanelli

Section 203(f) of the Advisers Act authorizes the Commission to bar or suspend a person from association with an investment adviser for willful violations of the Advisers Act, if it is in the public interest.²¹⁹ When considering whether an administrative sanction serves the public interest, the Commission considers the factors identified in *Steadman v. SEC*, 603 F.2d 1126,

²¹⁶ *Id.*

²¹⁷ Initial Decision at 59.

²¹⁸ *Id.*, citing *SEC v. Fin. News Assoc.*, No. 84-civ-878, 1985 WL 25023, at *2, *10 (E.D. Va. Apr. 26, 1985) (finding defendants violated the Advisers Act by making misleading statements in newsletters); *Blavin*, 557 F. Supp. at 1315; *SEC v. Suter*, No. 81-civ-3865, 1983 WL 1287, at *14 (N.D. Ill. Feb. 11, 1983).

²¹⁹ 15 U.S.C. § 80b-3(f); John W. Lawton, Advisers Act Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722, 61732 n.30, 61737 (collateral bars may be imposed based on conduct predating July 22, 2010).

1140 (5th Cir. 1979): (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations, (5) the respondent's recognition of the wrongful nature of his or her conduct; (6) and the likelihood that the respondent's occupation will present opportunities for future violations ("Steadman factors"). Ample evidence supports the Law Judge's conclusion to impose a permanent associational bar against Zavanelli.

As the Law Judge correctly found, Zavanelli's scienter weighs in favor of a permanent associational bar, and all other *Steadman* factors weigh heavily in favor of a permanent association bar.²²⁰

a. Zavanelli's Conduct was Egregious

The Law Judge correctly found Zavanelli's conduct was egregious and that this Steadman factor weighs heavily in favor of a permanent bar. The Law Judge compared the conduct to *Seaboard Investment Advisers, Inc.*, 54 S.E.C. 1111, 1118 (2001), as instructive on this issue.²²¹ In *Seaboard*, the respondents had been the subject of a 1994 cease-and-desist order relating to, among other things, advertising erroneously high performance figures. Thereafter, Seaboard issued individual client letters, which erroneously reported either high performance figures or low benchmark figures. After Seaboard settled a district court action involving post-1994 misconduct, a follow-on proceeding was instituted pursuant to Sections 203(e) and 203(f) of the Advisers Act. On appeal from the administrative law judge's initial decision, the Commission held that Seaboard's conduct was egregious, because "Respondents overstated the performance

²²⁰ Initial Decision at 63.

²²¹ *Id.* at 56.

of client portfolios by making inaccurate and false comparisons to market indices,” in an attempt to avoid losing customers as a result of the 1994 proceeding.²²²

The Law Judge correctly concluded that most of Zavanelli’s misconduct was egregious and comparable to that of the respondents in *Seaboard*, because both the Respondents in this case and the *Seaboard* respondents overstated the performance of client portfolios by making inaccurate and false comparisons to market indices.²²³ The Law Judge also found the violations concerning the Morningstar reports, which Zavanelli caused, were also egregious.

The Respondents ignore the violations the Law Judge found Zavanelli engaged in. Instead, they argue the Law Judge erred in finding Zavanelli’s conduct egregious because all ZPRIM clients received the performance return information omitted from the advertisements and there was no evidence any client relied on the advertisements. This argument is irrelevant. As the Law Judge correctly found, the issue is not whether any client was damaged or relied on the advertisements, as the Commission need not demonstrate reliance or damages. The evidence demonstrated Zavanelli made misrepresentations and omissions in the advertisements with a high level of scienter. That is the only relevant fact, and it demonstrates Zavanelli’s conduct in concealing the true nature of ZPRIM’s performance returns was egregious.

The Respondents’ reliance on *SEC v. Bengier*, Case No. 09-cv-676 (N.D. Ill. 2014), is misplaced. In *Bengier*, the District Court found the defendant’s failure to register as a broker-dealer was not so egregious as to warrant a permanent penny stock bar. That case did not involve fraudulent conduct, let alone the repeated concealment of performance returns, false

²²² *Id.*, citing *Seaboard*, 54 S.E.C. 1111.

²²³ *Id.*

claims of GIPS compliance, and false claims of no pending Commission investigation. The facts of *Benger* are wholly inapposite to the present action.

The Law Judge correctly found Zavanelli's violations were egregious and this Steadman factor weighs heavily in favor of a permanent bar.

b. Zavanelli Acted with Scierter

The Law Judge correctly found Zavanelli's scierter for the six magazine advertisements was high, because Zavanelli intended to conceal his poor performance from investors, and his scierter for the two newsletters was relatively low.²²⁴ As discussed more fully in Section IV.A(2) above, Zavanelli published advertisements claiming ZPRIM complied with GIPS while knowing the advertisements did not comply with GIPS, he claimed GIPS compliance because he knew that was important to the potential clients he was seeking to attract, and he did not include the GIPS-required information in the advertisements because it would have shown ZPRIM was underperforming its index benchmarks and had negative performance returns. Zavanelli knew the GIPS advertising guidelines, and ignored them.

The Respondents argue the unsupported position that a statistical analysis of scierter in the OIP reveals the Law Judge erroneously concluded this Steadman factor is met because 45 percent of the charges against ZPRIM did not involve Zavanelli or involved Zavanelli's relatively low scierter. There is no basis for this theory under the law. Nor can the Respondents identify any. Accordingly, the Commission should reject a statistical analysis approach to determining whether a Steadman factor is met.

Similarly flawed is the Respondents' reliance on *Benger*, Case No. 09-cv-676 and *In the Matter of Glassman*, 46 SEC 209 (1975). These cases are inapposite. As discussed above,

²²⁴ Initial Decision at 61.

Benger involved a defendant who failed to register as a broker with the Commission in violation of Section 15(a)(1) of the Securities Exchange Act of 1934. The violation did not involve any fraudulent conduct, and the Court declined to impose a permanent penny stock bar. Likewise, the Respondent in *Glassman* did not act with scienter, which was one factor the Commission considered in finding a 15-month suspension appropriate. By contrast, the Law Judge found Zavanelli acted with a high level of scienter by falsely claiming GIPS compliance and concealing ZPRIM's poor performance from investors, and that he also acted with scienter by making false claims of GIPS compliance in two newsletters.

Accordingly, the Law Judge correctly found this Steadman factor is met.

c. Zavanelli's Violations Were Recurrent

The Law Judge correctly found Zavanelli's violations were recurrent. Zavanelli violated the federal securities laws eleven times from October 2008 until May 2011.²²⁵ The Respondents' argument that the six violations concerning the 2008 and 2011 magazine advertisements arose from Zavanelli making only two decisions is meritless.²²⁶ This Steadman factor requires consideration of whether the violations were recurrent, and not whether the Respondents' deliberate decision to engage in the violation was recurrent. Here, the Law Judge correctly found the eleven violations demonstrated recurrent violations.

Similarly misplaced is the Respondents' reliance on *In Re Reserve Fund Securities and Derivative Litigation*, 2013 WL 5432334 *23 (S.D.N.Y. 2013). In that case, the Court found the passage of 30 years between violations did not establish the defendant as a repeat offender. Here, the issue is whether the violative conduct was recurrent, and the Law Judge correctly

²²⁵ *Id.* at 61.

²²⁶ Respondents' Brief at 37.

found Zavanelli engaged in violations that occurred in October, November, and December 2008, April and December 2009, September 2010, February, March and April 2011. This is not a case of unrelated violations, but a case of recurrent, violative conduct that spanned years. Accordingly, the Law Judge correctly found this Steadman factor weighs heavily in favor of a permanent bar.

d. Zavanelli Has Given No Sincere Assurances Against Future Violations and Has Not Recognized the Wrongful Nature of His Conduct

The Respondents' argument that the Law Judge erred in holding it against Zavanelli that he defended himself in this case is meritless and without support.²²⁷ The Law Judge did not rely on Zavanelli choosing to defend himself in finding this Steadman factor heavily weighs in favor of a permanent bar.²²⁸

Instead, the Law Judge explained this factor supported a permanent bar because Zavanelli repeatedly provided incredible testimony, concocted post-hoc rationalizations for his misdeeds, evaded responding to the Division's questions, repeatedly refused to accept directions from the Law Judge and from his own counsel, even with repeated reminders and sanction warnings. Zavanelli also endeavored — unfortunately, as the Law Judge noted, with some success — to evade the Commission's oversight by routing some ZPRIM communications through the ZPRIM Portal, and then gave false investigative testimony to keep the Division from inquiring further.²²⁹ Thus, the Law Judge correctly found, the evidence was overwhelming that Zavanelli “does not

²²⁷ *Id.* at 41.

²²⁸ Initial Decision at 62.

²²⁹ *Id.*

understand the regulatory and fiduciary responsibilities of an investment adviser,²³⁰ and this *Steadman* factor weighs heavily in favor of a permanent bar.

e. There is a Likelihood Zavanelli's Occupation will Present Opportunities for Future Violations

The Law Judge correctly found Zavanelli's occupation as a registered investment adviser presents opportunities for future violations.²³¹ The Respondents' argument that the Law Judge erred because ZPRIM's new management has taken steps to prevent the firm's future violations is irrelevant.²³² The issue is whether *Zavanelli's occupation* presents opportunities for future violations, and his occupation as an investment adviser clearly presents him with an opportunity to mislead clients in the future.

Accordingly, there is no merit to the Respondents' argument that the Law Judge erroneously found the *Steadman* factors support imposing a permanent bar against Zavanelli. As the Law Judge correctly held, it is in the Commission's interest to deter others from behaving like Max Zavanelli. In addition to intentionally misleading clients and prospective clients, he refused to accept responsibility for the abdication of his fiduciary duty to his clients. Therefore, it is in the public interest to permanently bar him from association with investment advisers, brokers, dealers, municipal securities dealers, municipal advisors, transfer agents, and nationally recognized statistical rating organizations.²³³

²³⁰ *Id.*, quoting *Seaboard*, 54 S.E.C. at 1120.

²³¹ *Id.* at 61.

²³² Respondents' Brief at 40.

²³³ Initial Decision at 63.

2. The Law Judge Correctly Imposed Second Tier Penalties

The Law Judge imposed penalties against Zavanelli totaling \$660,000.²³⁴ The Law Judge calculated this amount by determining the appropriate penalty for each violation, as follows:²³⁵

October 2008 SmartMoney advertisement	\$65,000
November 2008 SmartMoney advertisement	\$65,000
December 2008 SmartMoney advertisement	\$65,000
February 2011 SmartMoney advertisement	\$75,000
May 2011 SmartMoney advertisement	\$75,000
March 2011 Barron's advertisement	\$75,000
April 2009 newsletter	\$75,000
December 2009 newsletter	\$75,000
September 2010 Morningstar report (audited)	\$7,500
September 2010 Morningstar report (investigation)	\$7,500
March 2011 Morningstar report	\$75,000

The Law Judge imposed first tier penalties against Zavanelli for the two violations concerning the September 2010 Morningstar report because the Law Judge found the violations did not involve fraud, deceit, or deliberate or reckless disregard of a regulatory requirement. As discussed more fully below, the Law Judge correctly imposed second tier penalties for the other violations.

Under Section 203(i) of the Advisers Act, the Commission may impose a civil money penalty if a respondent willfully violated any provision of the Advisers Act, and if such penalty is in the public interest.²³⁶ A three-tier system establishes the maximum civil money penalty that may be imposed for each violation found.²³⁷ Where a respondent's misconduct involved fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, the Commission may

²³⁴ Initial Decision at 64-66.

²³⁵ *Id.* at 65.

²³⁶ 15 U.S.C. §§ 80b-3(i) (2006).

²³⁷ *Id.*

impose a “Second-Tier” penalty of up to \$65,000 for each act or omission by an individual and \$325,000 for an entity, for violations occurring between February 15, 2005, and March 3, 2009, and \$75,000 and \$375,000, respectively, for violations occurring between March 4, 2009, and March 5, 2013.²³⁸

Where an individual respondent’s misconduct did not involve fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, the Commission may impose a “First-Tier” penalty of up to \$6,500 or \$7,500, respectively.²³⁹ Within any particular tier, the Commission has the discretion to set the amount of the penalty.²⁴⁰

In determining whether a penalty is in the public interest, six factors may be considered: (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment and prior restitution, (4) the respondent’s prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require.²⁴¹

Applying these factors, the Law Judge correctly held second tier penalties against both Respondents was warranted.²⁴² The Respondents’ argument that the Law Judge’s conclusion was erroneous rests on their assertion that their conduct was merely negligent.²⁴³ As set forth

²³⁸ Id.; 17 C.F.R. §§ 201.1003, .1004 (adjusting the statutory amounts for inflation).

²³⁹ 15 U.S.C. §§ 80b-3(i); 17 C.F.R. §§ 201.1003, .1004.

²⁴⁰ See Brendan E. Murray, Advisers Act Release No. 2809 (Nov. 21, 2008), 94 SEC Docket 11961, 11978; The Rockies Fund, Inc., Exchange Act Release No. 54892 (Dec. 7, 2006), 89 SEC Docket 1517, 1528.

²⁴¹ 15 U.S.C. §80b-3(i); Brendan E. Murray, 94 SEC Docket at 11978.

²⁴² Initial Decision at 63.

²⁴³ Respondents’ Brief at 44.

above, the Law Judge correctly found that the Respondents acted with a high level of scienter by making false claims in the advertisements and concealing ZPRIM's negative performance returns, and acted with scienter in connection with the false Morningstar reports that falsely stated there was no Commission investigation.

The Respondents' do not address the Law Judge's additional findings to conclude second-tier penalties are warranted and in the public interest. They do not challenge the finding that the Respondents acted deceitfully and flouted the Commission's authority.²⁴⁴ Nor do they challenge the finding that Zavanelli has been sanctioned before, for similar misconduct.²⁴⁵ They do not and cannot challenge the finding that the need to deter the Respondents is strong, given Zavanelli's continued employment in the securities industry, continued involvement with ZPRIM, and failure to acknowledge the wrongfulness of his conduct.²⁴⁶ These findings, fully supported by the record, combined with the egregious nature of the Respondents' repeated violations, more than adequately support the Law Judge's conclusion to impose second-tier penalties.

Accordingly, the Law Judge correctly found that second-tier penalties were warranted with respect to the Respondents, and should have imposed a penalty of \$250,000 against ZPRIM and \$660,000 against Zavanelli.

C. The Respondents' Other Arguments

The Law Judge considered and rejected the Respondents' remaining arguments in the detailed Initial Decision. The majority of the Respondents' arguments rely primarily on their

²⁴⁴ Initial Decision at 63.

²⁴⁵ *Id.*

²⁴⁶ *Id.*

claim that the Law Judge erred in not crediting Zavanelli's testimony. However, as set forth throughout the detailed Initial Decision, the Law Judge found Zavanelli's testimony not credible, inconsistent, and evasive. The Commission should not disturb the Law Judge's credibility findings concerning Zavanelli.

The Respondents' argument that their false claims of GIPS compliance were not misleading because they complied with GIPS on other occasions reveals their misunderstanding of the law and the Law Judge's findings. The Law Judge found that ZPRIM and Zavanelli decided to change ZPRIM's advertisements in fall 2008 to omit the GIPS-required performance returns so they could conceal ZPRIM's negative performance returns and that ZPRIM was underperforming its Russell 2000 Index benchmark. Whether the Respondents were GIPS-compliant in other advertisements or practices does not obviate the fact – which they admitted in their Answer – that the advertisements at issue claimed GIPS compliance while failing to include the GIPS-required performance returns. The argument also ignores GIPS, which states a firm must comply with all requirements of GIPS to claim GIPS compliance.

Moreover, the Respondents' argument that GIPS provides for Error Correction Policies and details how a firm can correct their advertisements that fail to comply with GIPS is flawed. The Respondents presented no evidence that ZPRIM engaged in these corrective measures, even after Ashland and the Commission advised the firm that the advertisements did not comply with the GIPS advertising guidelines. This fact further supports the Law Judge's findings against the Respondents.

Similarly misplaced is the Respondents' argument that the Law Judge considered and referenced facts not claimed in the OIP, including the Respondents' deliberate efforts to conceal evidence and thwart the examination and investigative staff's efforts, and advertisements not

claimed in the OIP. The Law Judge correctly found the Respondents' conduct demonstrates their lack of respect for regulatory authority, but declined to impose an adverse inference against the Respondents. As the Initial Decision makes clear, the Law Judge found that while the facts supported an adverse inference, the Commission did not need it to demonstrate the Respondents violated the Advisers Act. Instead, the Law Judge based his findings on the Respondents' conduct in connection with the violations to find them liable. As for the Law Judge's references to other advertisements not at issue, the detailed findings in the Initial Decision make clear that the Law Judge considered the evidence concerning the advertisements claimed in the OIP to find the Respondents liable.

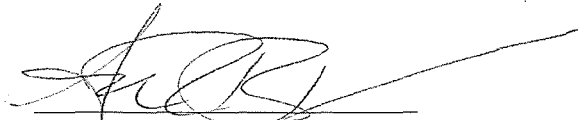
Accordingly, there is no merit to any of the Respondents' additional arguments. The Initial Decision is well-supported by citations to the evidence and law.

V. CONCLUSION

For all the forgoing reasons, the Division respectfully submits that the Law Judge correctly found that ZPR Investment Management, Inc. violated Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940, Respondent Max E. Zavanelli aided and abetted ZPRIM's violations of Sections 206(1), 206(2), and 206(4). The Division further submits that the Law Judge properly sanctioned ZPRIM by imposing a censure, cease-and-desist order, and civil penalties of \$250,000, and Zavanelli by imposing a permanent bar from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization, a cease-and-desist order, and civil penalties of \$660,000 are warranted.

Dated: September 22, 2014

Respectfully submitted,



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