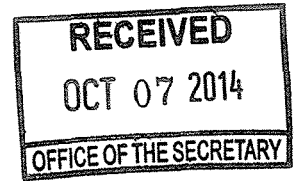


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**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**



In the Matter of

**ZPR INVESTMENT MANAGMENT, INC.,
and MAX E. ZAVANELLI**

Respondents.

**Administrative Proceeding
File No. 3-15263**

**APPELLANT-RESPONDENTS, ZPR INVESTMENT MANAGEMENT, INC.
AND MAX E. ZAVANELLI
REPLY BRIEF IN OPPOSITION TO
DIVISION OF ENFORCEMENT'S RESPONSE
TO RESPONDENTS' APPEAL OF INITIAL DECISION**

PHILIP J. SNYDERBURN, ESQUIRE

Florida Bar No. 0202592

E-Mail: psnyderburn@srsllaw.net

K. MICHAEL SWANN, ESQUIRE

Florida Bar No. 0442410

E-Mail: mswann@srsllaw.net

SNYDERBURN, RISHOI & SWANN, LLP

2250 Lucien Way, Suite 140

Maitland, Florida 32751

Telephone: 407-647-2005

Facsimile: 407-647-1522

Attorneys for Respondents

TABLE OF CONTENTS

	<u>Page Number</u>
TABLE OF AUTHORITIES	iii
I. INTRODUCTION	1
II. ERRONEOUS FINDINGS OF FACT	2
A. CLAIM OF GIPS COMPLIANCE	2
B. GIPS ADVERTISING GUIDELINES	4
C. ADVERTISEMENTS ARE NOT A PART OF THE GIPS VERIFICATION PROCESS	6
D. OCTOBER, NOVEMBER AND DECEMBER 2008 <i>SMARTMONEY</i> ADVERTISEMENTS WERE NOT CHANGED TO CONCEAL ZPRIM'S NEGATIVE PERFORMANCE RETURNS	7
E. 2011 MAGAZINE ADVERTISEMENTS	8
F. ZPRIM INVESTMENT NEWSLETTERS	9
G. ASHLAND'S CONCERNS ABOUT ZPRIM INVESTMENT NEWSLETTERS	9
H. ZAVANELLI'S CREDIBILITY WAS UNFAIRLY VIEWED	10
III. ZPRIM MATERIALITY REGARDING ADVERTISEMENTS	12
A. THE LAW ON MATERIALITY	12
B. THE "TOTAL MIX OF INFORMATION" RENDERED THE STATEMENTS IN THE ADVERTISEMENTS (MAGAZINE ADVERTISEMENTS, NEWSLETTERS AND <i>MORNINGSTAR</i> REPORTS) IMMATERIAL AS A MATTER OF LAW	14
C. THE INFORMATION PROVIDED TO A PROSPECTIVE CLIENT	15

	<u>Page Number</u>
D. PROOF THE UNDERPERFORMANCE OF THE FIRM WAS BEING DISCLOSED	16
E. THE 2011 MAGAZINE ADVERTISEMENTS	18
F. THE MONTHLY NEWSLETTERS CONTAINED NO MATERIAL MISSTATEMENTS	19
G. THE <i>MORNINGSTAR</i> REPORTS ARE NOT MATERIAL	20
1. The <i>Morningstar</i> Reports for 9/30/10 and 3/31/11	20
IV. RESPONDENTS DID NOT ACT WITH SCIENTER	22
A. MAGAZINE ADVERTISEMENTS	22
B. INVESTMENT NEWSLETTERS	24
C. <i>MORNINGSTAR</i> REPORTS	25
V. SANCTIONS	25
A. ASSOCIATIONAL BAR AGAINST ZAVANELLI	25
B. CIVIL PENALTIES	27
VI. CONCLUSION	28

TABLE OF AUTHORITIES

	<u>Page Number(s)</u>
CASES	
<i>Ash v. Lee Corp.</i> , 525 F. 2d 215, 219 (3d Cir. 1975)	12
<i>Basic, Inc. v. Levinson</i> , 485 U.S. 224, 236, 108 S.Ct. 978, 985, 99 L.Ed.2d 194, 211 (1988)	12, 16
<i>Bryant v. Avado Brands, Inc.</i> , 187 F.3d 1271, 1284 (11 th Cir. 1999)	22, 24
<i>In Re. AFC Enter., SEC Litig.</i> , 348 F.Supp.2d 1363, 1372 (N.D. Ga. 2004)	22
<i>In Re. Howard F. Rubin</i> , Release No. 35,179, 58 S.E.C. Docket 1426, 1994 WL 730446 at 1 (Dec. 30, 1994)	26
<i>In the Matter of Seaboard Investment Advisers, Inc.</i> , 54 S.E.C. 1111, 1118 (2001), 2001 SEC Lexis 2780	12
<i>Lovelace v. Software Spectrum, Inc.</i> , 78 F.3d 1015, 1020-21 (5 th Cir. 1996)	24
<i>Matrixx Initiatives, Inc. v. Siracusano</i> , 131 S.Ct. 1309, 179 L.Ed.2d 398, 2011 U.S. Lexis 2416 (2011)	16
<i>Mizzaro v. Home Depot, Inc.</i> , 544 F.3d 1230, 1238 (11 th Cir. 2008)	22
<i>PAZ Securities, Inc. v. SEC</i> , 494 F. 3d 1059, 1065 (D.C. Cir. 2007)	25
<i>Riggs Inv. Mgmt. Corp. v. Columbia Partners, LLC</i> , 966 F.Supp. 1250, 1262 (D.D.C.1997)	13
<i>SEC v. Metcalf</i> , Fed.Sec.L.Rep.P. 97,203 (S.D.N.Y. 2012)	26
<i>SEC v. Mannion</i> , 2014 WL 2957265, 6 (ND GA 2014)	26

	Page Number
<i>SEC v. Patel</i> ,..... 61 F. 3d 137, 141 (2d Cir. 1995)	26
<i>Steadman v. SEC</i> ,..... 603 F. 2d 1126, 1139 (5 th Cir. 1979)	25, 26
<i>TSC Indus., Inc. v. Northway, Inc.</i> , 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976)	12
<i>Virginia Bankshares, Inc. v. Sandberg</i> ,..... 115 L. Ed. 929, 11 S. Ct. 2749, 2760 (1991)	12

STATUTES AND RULES

Investment Advisers Act of 1940 (“Adviser’s Act”)	1, 13, 14, 16, 21, 25, 27
Section 206(2) of the Adviser’s Act	27
Section 206(4) of the Adviser’s Act	27
Rule 206(4)-(a)(5) of the Adviser’s Act	27

MISCELLANEOUS

Generally Accepted Accounting Principles (GAAP).....	22, 24
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I. INTRODUCTION¹

The findings by the Law Judge in the Initial Decision (“ID”) that ZPR INVESTMENT MANAGEMENT, INC. (“ZPRIM”) and MAX E. ZAVANELLI (“Zavanelli”) (collectively as the “Respondents”) violated the Investment Advisers Act of 1940 (“Adviser’s Act”) by misrepresenting compliance with the Global Investment Performance Standards (“GIPS”) in six (6) magazine advertisements erroneously concluded and did not consider the total mix of information available to prospective customers of ZPRIM; erroneously concluded that the GIPS Advertising Guidelines (“Guidelines”) applied to two (2) investment newsletters distributed by ZPRIM; and erroneously determined that the Respondents failed to accurately report a pending SEC investigation in two (2) *Morningstar* reports when *Morningstar* itself did not require this disclosure and used the term audit in one *Morningstar* report, which was immaterial.

The ID discredits the unrebutted testimony of Zavanelli on certain facts; places credibility on contradictory and unsubstantiated testimony of witnesses called by the Division of Enforcement (“Division”) and reaches conclusions not supported by the evidence.

Information that ZPRIM was disclosing to prospective customers revealed accurate performance results of its composites, both good and bad, during the periods that the six (6) magazine advertisements were placed. When examining this evidence with the advertisements at issue (the total mix of information available), no basis exists for a finding of scienter against the Respondents; the imposition of an associational bar against Zavanelli; or imposing Second Tier civil penalties against both Respondents. The claim of GIPS compliance contained in each of

¹ Citations to the transcript are noted as TR-___. Citations to the exhibits offered by the Division of Enforcement (“Division”) and the Respondents are noted as DX-__ and RX-__, respectively. Respondents’ supplemental exhibits are noted as RX-Supplement-__.

these six (6) advertisements cannot be viewed in isolation to determine materiality, which was the analysis followed by the Law Judge and is clearly erroneous.

It is undisputed that performance results of the ZPRIM composites contained in the six (6) magazine advertisements and two (2) investment newsletters raised in the Order Instituting Proceeding (“OIP”) were accurate and that no financial loss or other harm to any investor resulted from distributing this information. It is also undisputed that ZPRIM attracted no clients through *Morningstar* including the two (2) *Morningstar* reports at issue.

The associational bar against Zavanelli and the Second Tier civil penalties against both Respondents imposed by the ID are too severe and unwarranted. The Commission should either dismiss the charges against Respondents or impose lesser sanctions in the Tier One category due to a lack of any intent or severe recklessness by ZPRIM or Zavanelli to deceive or mislead any investors through the magazine advertisements, investment newsletters or *Morningstar* reports.

II. ERRONEOUS FINDINGS OF FACT

A. CLAIM OF GIPS COMPLIANCE

GIPS is a voluntary set of standards relating to the calculation and presentation of performance results administered by the CFA Institute.² The primary objective of GIPS is to achieve full disclosure and fair representation of investment performance by firms that claim compliance with GIPS.³

A firm cannot make a claim of GIPS compliance unless it has satisfied the GIPS standards⁴ which include:

² ID, pgs. 8, 9.

³ RX-3, pg. 2, Section I, ¶D.10.g.

⁴ *Id.* at pgs. 6, 7, Section II, ¶10 through 7.

- (i) Fundamentals of Compliance
- (ii) Input Data
- (iii) Calculation Methodology
- (iv) Composite Construction
- (v) Disclosures
- (vi) Presentation and Reporting
- (vii) Real Estate
- (viii) Private Equity

The Guidelines are separate from and are not a part of the GIPS standards.⁵ Firms can choose to have their performance measurement processes and procedures reviewed by an independent third party verifier but this process does not involve the examination of any advertisements. Verification tests whether a firm claiming compliance with the GIPS standards is following those standards⁶ by examining two items:

- (i) whether a firm has complied with all of the composite construction requirements of the GIPS standards; and
- (ii) whether the firm's processes and procedures are designed to calculate and present performance results in compliance with the GIPS standards.⁷

The ZPRIM engagement letters with Ashland Partners & Company, LLC ("Ashland") did not require or contemplate submission of advertisements since verification does not involve the review of that information.⁸ For the same reason, representation letters that ZPRIM signed as a

⁵ *Id.*

⁶ *Id.* at pg.21,Section III.

⁷ *Id.*

⁸ DX-37, 38.

condition of Ashland issuing a GIPS Verification Report⁹ do not mention or reference advertisements.¹⁰

Due to the fundamental difference between compliance with the GIPS standards and Guidelines, the Law Judge's findings that ZPRIM made a false claim of GIPS compliance in a standard footnote within each of the six (6) magazine advertisements were erroneous.¹¹ ZPRIM's claim of GIPS compliance has been verified as accurate by Ashland from December 31, 2000 through December 31, 2009¹² and then by Alpha Performance Verification Services ("Alpha") from December 31, 2009 through December 31, 2013¹³. In addition, the accuracy of all performance results in these advertisements was undisputed and not at issue in this proceeding.¹⁴

B. GIPS ADVERTISING GUIDELINES

The Guidelines are a set of requirements separate from the GIPS standards and apply when a firm makes a claim of GIPS compliance in an advertisement.¹⁵ The Guidelines provide a checklist of items that an advertisement should contain and includes performance results for the composite being advertised.¹⁶

Admittedly, ZPRIM did not include period to date performance results for its Fundamental Small Cap Value ("SCV") composite and either 1, 3 and 5 year cumulative annualized returns or 5 years of annual returns as required by the 2005 Guidelines in the

⁹ RX-14.

¹⁰ DX-39.

¹¹ ID, pgs.47-49.

¹² RX-14.

¹³ RX-22;RX-Supplement-52.

¹⁴ ID,pg.49.

¹⁵ RX-3,pg.33, ¶A.

¹⁶ *Id.* pg.34, ¶B.

October, November and December 2008 *SmartMoney* advertisements.¹⁷ ZPRIM also did not include 1, 3 and 5 year annualized returns through the most recent period for its Global Equity and All-Asian or alternative performance returns for these composites as required by the 2010 Guidelines in the February and May 2011 *SmartMoney* advertisements or the March 2011 *Barron* advertisement.¹⁸ These deficiencies did not render ZPRIM's claim of GIPS compliance in the advertisements false or untrue as the ID erroneously found.¹⁹ ZPRIM's GIPS verifier Nikola Feliz ("Feliz") testified that mistakes made in advertisements did not adversely affect a claim of GIPS compliance if the mistakes were corrected.²⁰ This testimony follows the GIPS Error Correction Policies²¹ and guidance provided by the GIPS Helpdesk²². The Law Judge's finding that "Firms that do not meet all of GIPS requirements cannot represent that they are in compliance with GIPS,"²³ therefore, is clearly erroneous. Strict liability does not arise due to a firm's failure to follow the Guidelines when those deficiencies are corrected.

The evidence established that ZPRIM disclosed performance results required by GIPS to prospective customers through its website, bar graphs, performance charts, and other information²⁴ and provided a GIPS Compliant Presentation to every prospective client.²⁵ These disclosures cured and corrected the deficiencies contained in the six (6) magazine advertisements and provided full and fair disclosure of ZPRIM's performance. These disclosures revealed that ZPRIM's SCV composite was under performing its benchmark, the Russell 2000 Index, during

¹⁷ RX-5,6,and7;RX-3,pg.34, ¶B.5.

¹⁸ RX-15,17and19;RX-4,pgs.29,30, ¶B.5.

¹⁹ ID,pgs.8,9.

²⁰ TR-1029, 1069.

²¹ RX-40, 41.

²² RX-34.

²³ ID, pgs.8, 9.

²⁴ RX-8-11, 16, 18 and 20.

²⁵ ID,pg.9, footnote 6.

the time the 2008 fall *SmartMoney* advertisements were run and negate any finding by the Law Judge that Respondents intended to deceive or mislead any prospective or actual clients. These disclosures also prove performance results required by the respective Guidelines were provided to prospective clients.

C. ADVERTISEMENTS ARE NOT A PART OF THE GIPS VERIFICATION PROCESS

The evidence presented demonstrated that while ZPRIM provided marketing materials to Ashland as part of the ongoing GIPS verification process, advertisements were typically not provided.²⁶ The advertisements were not intentionally withheld from Ashland by ZPRIM.²⁷ The Respondents believed they were not required to provide advertisements to Ashland as part of the GIPS verification process and Ashland never requested that ZPRIM send advertisements for review even after Ted Bauchle (“Bauchle”)²⁸ sent Ashland a copy of a magazine advertisement ZPRIM ran in January 2008²⁹. Feliz testified that all information Ashland requested to verify ZPRIM’s claims of GIPS compliance was provided by Bauchle.³⁰ Since the Respondents were not aware that advertisements should have been sent to Ashland³¹ and Ashland never requested that advertisements be sent, the Law Judge’s finding that Zavanelli instructed Bauchle not to send advertisements to Ashland was not supported by the evidence and thus, clearly erroneous.

²⁶ ID,pg.15.

²⁷ Initial Brief, ¶G, pgs.15-18.

²⁸ Bauchle was ZPRIM’s main contact with Ashland for GIPS matters. DX-40. Bauchle also testified that he had primary responsibility for GIPS compliance on behalf of ZPRIM. TR-186.

²⁹ DX-55.

³⁰ TR-1042, 1043.

³¹ RX-13.

D. OCTOBER, NOVEMBER AND DECEMBER 2008 SMARTMONEY ADVERTISEMENTS WERE NOT CHANGED TO CONCEAL ZPRIM'S NEGATIVE PERFORMANCE RETURNS

Performance results required by the Guidelines were not omitted from ZPRIM's fall 2008 *SmartMoney* Advertisements to conceal SCV's under performance against its bench mark as the Law Judge incorrectly determined.³² Information showing performance of the SCV composite was disclosed on ZPRIM's website³³ with bar charts indicating SCV was under performing the Russell 2000 Index. Examples of performance results sent to prospective investors by ZPRIM during the third and fourth quarter 2008 also showed the SCV composite was performing poorly both overall and against the Russell 2000.³⁴ Bauchle also testified that all prospective clients of ZPRIM received a GIPS Compliant Presentation,³⁵ which was a requirement of the GIPS standards.³⁶ These disclosures, which were made to ZPRIM prospective clients before they became clients, would not have been provided if the Respondents had truly wanted to conceal performance results.

Zavanelli was not involved in creating the advertisement format used to place the 2008 *SmartMoney* ads and did not review these ads before they were published.³⁷ After these ads had run and Respondents realized that performance results required by the Guidelines were not included, the format used to place the 2008 *SmartMoney* advertisements was never repeated, which corroborates Zavanelli's testimony.³⁸

³² ID,pg.52.

³³ RX-8, 9.

³⁴ RX-10,11.

³⁵ TR-407,408.

³⁶ RX-3, pg.8, ¶10.A.11.

³⁷ Initial Brief, pgs.23-26.

³⁸ DX-21.

E. 2011 MAGAZINE ADVERTISEMENTS

ZPRIM reprinted tables published by *Pensions and Investments* in the February 2011 issue of *SmartMoney* magazine to show that its Global Equity and All-Asian composites had outperformed their top competitors.³⁹ For the same reasons, ZPRIM also reprinted tables published by *Pensions and Investments* in a March 21, 2011, issue of *Barron's* magazine and later in the May 2011 issue of *SmartMoney*.⁴⁰

Had performance results required by the Guidelines been included in these advertisements, those results would have revealed that the Global Equity and All-Asian composites were both significantly out performing their respective benchmarks for the relevant periods.⁴¹

The omitted performance results required by the Guidelines were also disclosed to prospective clients who requested information from ZPRIM when the 2011 ads were placed.⁴² In addition, all prospective clients received a GIPS Compliant Presentation before becoming an actual client of ZPRIM.

ZPRIM's failure to include performance results in the 2011 ads required by the Guidelines showing it was substantially outperforming its benchmarks was, therefore, not done with any wrongful intent as the Law Judge erroneously found⁴³ and did not result in any harm to the investing public.

³⁹ RX-15.

⁴⁰ RX-17, 19.

⁴¹ RX-16, 18, 22.

⁴² RX-16, 18, 20.

⁴³ ID,pg.50.

F. ZPRIM INVESTMENT NEWSLETTERS

The April and December 2009 issues of ZPRIM's monthly newsletter did not contain a claim of GIPS compliance that required compliance with the Guidelines⁴⁴ and the December 2009 issue specifically made a claim it was not GIPS compliant.⁴⁵ The Law Judge also concluded that Zavanelli sincerely believed the ZPRIM investment newsletter was not an advertisement⁴⁶ and Zavanelli testified that he did not use the newsletter to market or solicit prospective clients⁴⁷.

It was, therefore, clearly erroneous for the Law Judge to determine that a claim of GIPS compliance in these investment newsletters was misleading.

G. ASHLAND'S CONCERNS ABOUT ZPRIM INVESTMENT NEWSLETTERS

In November 2008, when Ashland informed ZPRIM that investment newsletters which claimed GIPS compliance and showed performance results should comply with the Guidelines or include a GIPS Compliant Presentation to recipients of the investment letter,⁴⁸ ZPRIM was posting GIPS Compliant Presentations on its website.⁴⁹ ZPRIM also provided prospective clients with a GIPS Compliant Presentation as required by the GIPS standards.⁵⁰ Since the GIPS Compliant Presentations were being disclosed and sent to prospective clients, Zavanelli testified that he did not see the need to include this information again with each issue of the ZPRIM investment newsletter.⁵¹

⁴⁴ Initial Brief, pgs.26, 27.

⁴⁵ RX-24,pg.4.

⁴⁶ ID,pg.54.

⁴⁷ TR-1439.

⁴⁸ DX-47.

⁴⁹ RX-8.

⁵⁰ RX-3,pg.8, ¶O.A.11; TR-1065 (Feliz testimony acknowledged ZPRIM provided prospective clients with its most recent GIPS Compliant Presentation).

⁵¹ TR-1449.

In March 2010, Zavanelli spoke with Feliz and one of Ashland's partners to discuss the applicability of the Guidelines to the ZPRIM investment newsletters.⁵² After this call and his explanation that a GIPS Compliant Presentation was being provided to every prospective client, Zavanelli honestly felt Ashland's concerns about the newsletter had been addressed.⁵³

After this conversation, however, Ashland sent a letter to Bauchle, but not Zavanelli, providing two options for ZPRIM to follow regarding the Guidelines and the investment newsletter.⁵⁴ One option suggested that ZPRIM remove any references to GIPS in the newsletter, which Zavanelli testified he would have followed.⁵⁵ The evidence demonstrated that Zavanelli did not see Ashland's letter until well after it resigned as ZPRIM's GIPS verifier and he was not aware of that option.⁵⁶

H. ZAVANELLI'S CREDIBILITY WAS UNFAIRLY VIEWED

Findings about Zavanelli's credibility were clearly erroneous and not supported by the evidence. Zavanelli's testimony was not inconsistent, confusing or evasive on the following issues:

- Zavanelli had ultimate responsibility for ZPRIM's GIPS compliance⁵⁷ while Bauchle had primary responsibility for the firm's GIPS compliance and was listed as the main contact for Ashland⁵⁸.
- There was no evidence Zavanelli instructed Bauchle to stop sending advertisements to Ashland after January 2008.

⁵² TR-1456.

⁵³ *Id.*

⁵⁴ DX-52.

⁵⁵ TR-1458.

⁵⁶ *Id.* at 1457.

⁵⁷ TR-836.

⁵⁸ TR-186;DX-40.

- Evidence demonstrated that Zavanelli did not review Ashland's undated letter⁵⁹ that was sent to Bauchle regarding Guidelines and the ZPRIM investment newsletter until after Ashland resigned as ZPRIM's GIPS verifier.⁶⁰
- Evidence demonstrated that Zavanelli had no involvement in creating ZPRIM's fall 2008 advertisements.⁶¹
- Evidence demonstrated that retail investors had no access to *Morningstar* reports.⁶²
- The OIP did not charge the Respondents with any record keeping violations and evidence relating to the "ZPR Portal" was irrelevant.⁶³
- The evidence demonstrated that Zavanelli was not aware of information requested by *Morningstar* until after the two reports raised by the OIP were published.⁶⁴ The evidence also clearly demonstrated that ZPRIM's obligation to disclose a pending SEC investigation to *Morningstar* did not arise until after a "charge" was made.⁶⁵

As the Respondents' Initial Brief stated, Zavanelli has a right to defend himself in this proceeding and is a lay person, not a legal professional.⁶⁶ While Zavanelli was at times a difficult witness, he also apologized on numerous occasions for his behavior.⁶⁷ Under highly stressful circumstances because his life's work was the subject of the SEC's allegations, Zavanelli's demeanor should not have been used to discredit his testimony.

⁵⁹ DX-52.

⁶⁰ TR-1457.

⁶¹ RX-46-48.

⁶² RX-37.

⁶³ RX-1.

⁶⁴ ID,pg.32.

⁶⁵ RX-38.

⁶⁶ Initial Brief,pgs.41,42.

⁶⁷ ID,pg.44,45.

III. ZPRIM MATERIALITY REGARDING ADVERTISEMENTS

A. THE LAW ON MATERIALITY

The Law Judge erroneously concluded that a claim of GIPS compliance or failure to disclose under performance results in the 2008 *SmartMoney* advertisements were material facts under the “total mix of information” provided to a prospective client. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). The Law Judge gave no weight to the other information provided to a prospective client before they invested. “Total mix of information” may include data sent to shareholders in addition to proxy materials. *Ash v. Lee Corp.*, 525 F.2d 215, 219 (3d Cir. 1975). However, information sent to shareholders need not be considered part of the total mix reasonably available to them if “the true” is “buried” in unrelated materials. *Virginia Bankshares, Inc. v. Sandberg*, 495 U.S. 903, 11 S.Ct. 2749, 2760, 115 L.Ed.2d 929, (1991).

The evidence showed that after reading the advertisements, a prospective investor would be given additional performance information, which supplemented the information in the advertisements.⁶⁸ This additional information was part of the “total mix” and more importantly, the “true” was not “buried” in unrelated materials.

The Law Judge’s reliance on *In the Matter of Seaboard Investment Advisers, Inc.*, 54 S.E.C. 1111, 1118 (2001), 2001 SEC Lexis 2780, is misplaced. In *Seaboard, supra*, at 1117, the adviser Hansen “overstated the performance of client portfolios by making inaccurate and false comparisons to market indices”. There is no allegation in the OIP that the Respondents falsified any client performance numbers. Of the 24 advertisements admitted into evidence only three placed in the fall of 2008 were alleged to have been fraudulent by failing to disclose year to date

⁶⁸ RX-10-11.

performance. As noted, year to date performance was provided to any prospective investor by ZPRIM after they read the advertisement but before becoming a client. There is no allegation or evidence that any of the performance numbers when measured against the market indices in any of the 24 advertisements were inaccurate.

The Law Judge also incorrectly compared the facts of this case to those in *Riggs Inv. Mgmt. Corp. v. Columbia Partners, LLC*, 966 F.Supp. 1250, 1262 (D.D.C.1997). *Riggs* did not involve a violation of the Adviser's Act or any securities laws. It was a "raiding" case involving a group of former investment advisers that left Riggs to join another investment firm. Riggs sued the firm claiming breach of fiduciary duty and a violation of the Lanham Act for misleading statements in commercial advertising. The former employees at Riggs had an impressive investment track record they used at the new firm to create an illusion that the new firm had acquired the entire Riggs team, which was false. In preparing marketing information, the compliance officer for the new firm consulted with AIMR (predecessor to GIPS) but failed to disclose that certain Riggs advisers had not joined the new firm. AIMR recommended changes to the marketing materials which the new firm did not follow or implement but stated it was AIMR compliant.

The court found that claiming to have complied with such an important industry standard "while knowingly being out of compliance is false advertising." *Riggs, supra*, 1268.

By contrast, ZPRIM's claim of "GIPS" compliance in the advertisements was accurate since the firm was verified as GIPS compliant. A failure to follow the Guidelines, which are not GIPS standards, does not falsify a claim of GIPS compliance if, as previously discussed, the deficiencies are corrected.

B. THE “TOTAL MIX OF INFORMATION” RENDERED THE STATEMENTS IN THE ADVERTISEMENTS (MAGAZINE ADVERTISEMENTS, NEWSLETTERS AND MORNINGSTAR REPORTS) IMMATERIAL AS A MATTER OF LAW

The Division contends the advertisements were fraudulent because material facts were omitted (performance on a year to date basis would show underperformance of the indices) or materials facts were misrepresented (the firm is GIPS compliant but failed to follow the Guidelines or claiming the firm’s results had been “audited” rather than using the word “verified”). If the statements made in the various advertisements (which assumes the newsletters and the Morningstar reports are advertisements) are not material, then there can be no violation of the Adviser’s Act. The “total mix of information” provided to a prospective client **after the advertisements were published and before the client became an investor** proved that references made to the firm’s claim of GIPS compliance were accurate and all performance results including period to date were also accurate. Upon expressing interest, a prospective client would be sent a plethora of information regarding the firm and its performance on a monthly, quarterly and annual basis,⁶⁹ which demonstrated the firm had underperformed its indices during 2008. As a result, the “misrepresentations or omissions of facts” in the advertisements were not material when viewed with the “total mix of information” given to a prospective client.

C. THE INFORMATION PROVIDED TO A PROSPECTIVE CLIENT

Every prospective client of the firm before becoming a client was given a GIPS Compliant Presentation. This information would be provided **after** the prospective client had read the advertisement and before becoming a client of the firm. The presentation reflects how the firm performed and measures that performance against the relevant market indices.⁷⁰ The

⁶⁹ RX-8-11,16,18,20.

⁷⁰ RX-14.

GIPS Compliant Presentation is a finding by the GIPS verifier that the firm's claimed performance is accurate. ZPRIM's performance results were verified by a GIPS verification firm from 2000 through today and the performance was accurate. Each Verification Report stated, "In our opinion, the company, in all material respects, has complied on a firm-wide basis with the composite construction requirements of the GIPS standards as adopted by CFA Institute."⁷¹ Each prospective client was also given access to the firm's website, which contained performance data from 2000 through all periods mentioned in the OIP. This information included monthly, quarterly and annual performance data and described how the various composites measured up against various indices. A prospective client would sometimes be given the monthly newsletter, which reported how the firm had performed that month. After receiving all of this information, the prospective client would then decide to retain the firm as their adviser. The decision to invest would not be made lightly since depending on the desired composite, the minimum investment was between \$200,000 and \$350,000, which was prominently displayed in the advertisements. This was not a "Mom and Pop" pitch and common sense dictates that no one would invest such significant amounts based upon an advertisement alone. A prospective client, after reading the advertisement, would necessarily engage in further "due diligence" to understand the firm and its claims regarding performance. When a prospective client decided to become a client, **everything about the firm and its performance had been disclosed. And everything the firm reported was accurate.**

When considering the "total mix of information" given to a prospective client, the magazine advertisements in question were the starting points in providing full and fair disclosure, not the end point. The ID only focuses on the advertisements as a point in time while

⁷¹ *Id.* RX-22,RX-Supplement-52.

ignoring disclosures given after that point in time. More importantly, the ID found the disclosures given before an investment decision was made but after the advertisements were published to be irrelevant.⁷² The ID, contrary to overwhelming judicial decisions, rendered the concept of the “total mix of information” a nullity.

This “bright-line rule” that a failure to comply with the Guidelines results in strict liability under the Adviser’s Act has been rejected by the United States Supreme on at least two occasions. *See Basic, supra*, at 236, 108 S. Ct. 978 (“[a]ny approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over inclusive or under inclusive.”) *See also Matrixx Initiatives, Inc. v. Siracusano*, 131 S.Ct. 1309, 1318, 179 L.Ed.2d. 398, 2011 U.S. Lexis 2416 (2011) (rejecting a “bright-line rule that reports of adverse events associated with a company’s pharmaceutical products cannot be material absent a sufficient number of such reports). Both *Basic* and *Matrixx, supra*, emphasized the nondisclosed information must have “significantly altered the “total mix” of information. *See Basic, supra*, at 108 S. Ct. 978 and *Matrixx, supra*, at 131 S. Ct. 1321. In the present matter, the “total mix” of information given to a prospective client rendered failing to comply with the Guidelines immaterial.

D. PROOF THE UNDERPERFORMANCE OF THE FIRM WAS BEING DISCLOSED.

The most serious allegation made by the Division involved ZPRIM’s fall 2008 advertisements that omitted SCV period to date results, which were underperforming its indices. Of the 24 magazine advertisements admitted into evidence, only three are charged with this allegation. There is no claim the other 21 advertisements were fraudulent in this fashion. The

⁷² ID,pg.58.

Division contends failing to disclose the period to date performance was fraudulent because the SCV composite return underperformed its indices during this time. This assertion does not consider information a prospective investor would be given, which included a chart showing SCV had underperformed its indices on a year to date basis.⁷³ This chart showed, as of June 2008, ZPRIM SCV composite was -26% while the Russell 2000 index was -16%. Charts in this same exhibit showed ZPRIM's Global Equity composite, as of June 30, 2008, was underperforming its index: Global Equity -2.70% vs -.58%. Other information provided to investors in August of 2008 was contained in RX-11, pg.2, and showed performance of SCV -19% vs Russell 2000 index at -9%. A prospective client would sometimes be given a monthly newsletter. The newsletter for November of 2008 provided comments from Zavanelli stating "That was my third worst investment experience. I should have seen it coming. There was the constant barrage of negative press that eventually would break the confidence of investors."⁷⁴ The same newsletter on page 14 contained a chart entitled "**Previous Rotten Quarters**" and on page 1 reported that "**My apologies to everyone for not seeing this plunge coming.**" The firm's website, which is identified in all of the advertisements, showed the SCV composite was underperforming the Russell 2000 index in the first and third quarters of 2008 as follows:⁷⁵ first quarter ZPRIM SCV -19% vs Russell 2000 index -9%; third quarter ZPRIM SCV -1.69% vs Russell 2000 index -1.12%. The same document stated the one year performance for SCV was 18% while the Russell 2000 index was 24%, again showing underperformance. **Based on these disclosures, a reasonable investor could not have concluded the firm was beating the market in the fall of 2008 after receiving the "total mix of information" for performance**

⁷³ RX-10,pg.3.

⁷⁴ DX-71,pg.1.

⁷⁵ RX-29,pg.2.

results. The proof is in the pudding and the evidence demonstrated that no investors retained the firm in the fall of 2008 after the advertisements were published.⁷⁶ These investors knew ZPRIM had no magical solution to the great recession in 2008 and was losing more money than the comparable indices. Full and fair disclosure of all material facts was provided and the investors voted---- they did not invest.

E. THE 2011 MAGAZINE ADVERTISEMENTS

The Division claims that three other advertisements in 2011 were also fraudulent. The 2011 magazine advertisements reprinted rankings of investment managers compiled by *Morningstar* and *Pensions and Investments* and there is no dispute Zavanelli was rated by *Morningstar* as a 5 star manager.

Because the firm included in a footnote to the advertisements that it was GIPS compliant, the OIP claimed the advertisements were misleading since performance results required by the Guidelines were not included. In the “total mix of information” a prospective investor was provided with these performance results even though they were not contained in the advertisements themselves.⁷⁷

A prospective client in 2011 would also have been given the GIPS Compliant Presentation prepared by Alpha.⁷⁸ The Alpha report for “All-Asian” and “Global Equity” showed performance since inception and on an annual and quarterly basis, which is the exact information the Division contended was missing from the advertisements. That missing information showed that ZPRIM was crushing its benchmarks: Global Equity 46% vs MSCI EAFE Index 8%; All-Asian 71% vs MSCI EAFE Index 8% as of 12/31/2010.

⁷⁶ ID,pg.27.

⁷⁷ RX-16,18,20.

⁷⁸ RX-22.

Another example of full disclosure provided by ZPRIM was the information disclosed on the firm's website.⁷⁹ The website contained 1, 3, 5, 10 year performance, since inception and on a quarterly basis. The Global Equity composite reflected a compounded return of 720% compared to a 66% return for its benchmark. There is no claim or finding these performance numbers on ZPRIM's website were inaccurate.

Because of the "total mix of information" being provided, the so called misrepresentations or omissions in the 2011 advertisements were not material.

F. THE MONTHLY NEWSLETTERS CONTAINED NO MATERIAL MISSTATEMENTS.

The Division contends two (2) investment newsletters were also fraudulent because in a footnote, ZPRIM claimed GIPS compliance but failed to follow the Guidelines, which required period to date and 1, 3, and 5 annualized or 5 years of annual performance results. Prospective clients were inundated by ZPRIM with performance numbers required by the Guidelines before investing with the firm, all of which have been proven to be accurate. The December 2009 newsletter, one of two charged in the OIP stated, "**Our report remains not GIPS compliant.**"⁸⁰ If a claim of GIPS compliance regarding voluntary advertising guidelines is material to a prospective client in a newsletter, this disclaimer disavows GIPS compliance for the newsletter.

The cardinal sin in the December 2009 newsletter, according to the OIP, is to republish performance results that did not include period to date returns. While the information reported in the newsletter was accurate, the Division claims that simply failing to comply with the Guidelines renders the newsletter fraudulent. The ID ignores the fact period to date returns for all of the composites were listed on the firm's website. In the "total mix of information," which

⁷⁹ RX-29.

⁸⁰ RX-24,pg.4.

includes a statement of non-compliance with GIPS within the newsletter, no reasonable investor could conclude this was material.

The second alleged fraudulent newsletter was ZPRIM's April 2009 issue.⁸¹ That newsletter contained an article on the "up-tick" rule and how it affected performance returns for the ZPRIM SCV composite. Again, there is no claim the performance numbers are inaccurate. The article outlines that when the "up-tick" rule was in effect, ZPRIM's performance returns were enhanced but when the "up-tick" rule was discontinued the returns declined. The article then stated in a footnote that ZPRIM was GIPS compliant.

The ID determined that failing to adhere to the voluntary Guidelines, without more, renders the newsletter misleading. Period to date performance results required by the Guidelines, however, are unrelated to a discussion about the "up-tick" rule and failing to follow the Guidelines did not affect an investor's decision to continue using the firm.

Providing information about the firm's 1, 3, and 5 year performance does not change an investor's opinion of whether the "up-tick" rule is good or bad. Because the firm always had discretion in trading as an adviser, the "up-tick" rule is of no consequence. It is what it is. Once again, the ID grasps at the notion that failing to follow the voluntary Guidelines automatically equates to fraud without looking at the overall "total mix of information."

G. THE MORNINGSTAR REPORTS ARE NOT MATERIAL

1. The *Morningstar* Reports for 9/30/10 and 3/31/11.

The OIP alleged ZPRIM made a false statement in the 9/30/10 *Morningstar* report when it claimed that it was being audited by GIPS verification firm, Ashland, since Ashland had resigned in July of 2010. A subsequent *Morningstar* report for 3/31/2011, showed the error

⁸¹ RX-23,pg.3.

regarding Ashland had been corrected and a new verification firm, Alpha, was identified.⁸² It is clear that a reasonable investor would not have relied on the statement in the 9/30/10 *Morningstar* report because:

In September of 2010, a prospective investor would have received the GIPS Compliant Presentation for 2009, which was prepared by Ashland since the 2010 GIPS presentation would not have been available until early 2011. A prospective investor would have been directed to the firm's website, which provided quarterly performance information for 2010 and earlier periods.

Alpha delivered its GIPS opinion to ZPRIM on February 4, 2011, which verified GIPS compliance of the firm for 2010⁸³ and this report was also provided to all of the firm's clients annually. As a result, the firm's performance had been verified for 2010, which was the issue. More importantly, all of this performance information would have been delivered to any prospective investor who became a client and would confirm what the investor had read on 9/30/10. Also, Feliz testified that using the word "audit", in her opinion, was not material.⁸⁴ Thus, the 9/30/10 *Morningstar* report did not violate the Adviser's Act.

The second claim regarding the *Morningstar* reports related to the failure of the firm to disclose the SEC investigation. The evidence demonstrated that if the "Pending SEC Investigation" box were checked "yes", then "charges" had to be described. Since there were no charges in either 2010 or 2011, Bauchle testified he checked "no" for this item.⁸⁵ When charges

⁸² DX-26,pg.9.

⁸³ RX-22.

⁸⁴ TR-1068,1069.

⁸⁵ ID, pg.33.

were filed by the SEC in 2013, the firm amended its Form ADV to disclose the charges and disclosed the charges in the *Morningstar* data base.⁸⁶

IV. RESPONDENTS DID NOT ACT WITH SCIENTER

A. MAGAZINE ADVERTISEMENTS

While the technical requirements of the Guidelines were not followed by ZPRIM in six (6) advertisements, the evidence demonstrated the Respondents' conduct did not rise to the legal standard of scienter, which requires a "showing of either an intent to deceive, manipulate, or defraud, or severe recklessness." *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1238 (11th Cir. 2008) [quoting *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1284 (11th Cir. 1999)]. Violations of standards such as Generally Accepted Accounting Principles (GAAP) without more, are insufficient to create an inference of fraud. *In Re. AFC Enter., SEC Litig.*, 348 F.Supp.2d 1363, 1372 (N.D. Ga. 2004).

The list of instances⁸⁷ cited by Division through its Response Brief to support the Law Judge's findings of scienter against the Respondents do not satisfy the proper legal threshold that is required, especially when all of the evidence is reviewed.

The evidence showed that Zavanelli had no involvement in creating the fall 2008 *SmartMoney* advertisements and did not see final copies of these advertisements until after they had been published.⁸⁸ He did not and could not have known that the advertisements did not contain the performance results required by the Guidelines. Advertisements placed by ZPRIM both before and after the 2008 fall *SmartMoney* advertisements contained performance results

⁸⁶ RX-38.

⁸⁷ Division's Brief at 32-34.

⁸⁸ RX-46-48;TR-1415,1416.

required by the Guidelines⁸⁹, which also demonstrates there was no intent by the Respondents to simply ignore the Guidelines and place advertisements designed to deceive, mislead, or defraud prospective clients.

Disclosures of charts, graphs, performance results, and other information that showed ZPRIM's SCV composite was underperforming its benchmark in 2008 also support this conclusion.⁹⁰

Thus, no potential danger or harm to prospective clients could possibly have been created by the 2008 ZPRIM fall advertisements, which at worst, negligently omitted performance results required by the Guidelines.

An examination of the performance results not included by ZPRIM in the 2011 magazine advertisements and the total mix of information disclosed by ZPRIM to prospective clients also reveals that the Respondents did not act with any degree of scienter. As discussed, if performance results required by the Guidelines had been included by ZPRIM in the 2011 magazine advertisements at issue⁹¹, the Global Equity and All-Asian composites consistently outperformed their respective benchmarks.⁹² These performance results were also provided to prospective clients that responded to these advertisements.⁹³

Accordingly, when the total mix of information being disclosed by ZPRIM is considered, a finding of scienter by the Law Judge was wrong as no potential harm or danger was created by the 2011 advertisements.

⁸⁹ RX-21.

⁹⁰ RX-8-11.

⁹¹ RX-15,17and19.

⁹² RX-16,18,20,and22.

⁹³ *Id.*

B. INVESTMENT NEWSLETTERS

The Law Judge found that Zavanelli genuinely believed that ZPRIM investment newsletters were not advertisements.⁹⁴ Zavanelli also believed that ZPRIM was complying with the GIPS standards by routinely providing all prospective clients with ZPRIM's GIPS Compliant Presentation.⁹⁵ He, therefore, did not agree with Ashland's recommendation to attach the GIPS Complaint Presentation to the investment newsletter⁹⁶, but this disagreement was based upon Zavanelli's good faith interpretation of the GIPS standards and not on any intent to ignore GIPS.

The Law Judge's findings that the Respondents acted with scienter in failing to follow the Guidelines in the ZPRIM April and December 2009 investment newsletters also cannot stand as there is no evidence to suggest that the Respondents' conduct satisfied the legal standard required for scienter. *Bryant, supra*. No claim of GIPS compliance was made in these newsletters to trigger the applicability of the Guidelines since the only references to GIPS were unrelated to any marketing or advertising efforts by ZPRIM. In addition, the December 2009 newsletter specifically disclaimed that it was GIPS compliant.⁹⁷

The evidence demonstrated that Respondents did not act with any intent or severe recklessness to deceive, mislead, or defraud anyone that received these newsletters. Mere violations of the Guidelines do not support a finding of scienter. *Lovelace v. Software Spectrum, Inc.*, 78 F.3d 1015, 1020-21 (5th Cir. 1996) (involving GAAP).

⁹⁴ ID,pg.54.

⁹⁵ TR-225,226.

⁹⁶ ID,pg.19.

⁹⁷ RX-24,pg.4.

C. *MORNINGSTAR* REPORTS

The evidence likewise showed that the Respondents did not act with any scienter regarding the March 31, 2011, *Morningstar* report. As discussed, *Morningstar* did not require that an SEC investigation be disclosed until after a “charge” was made⁹⁸ and no charges were filed against the Respondents until the OIP issued. The Law Judge found that Zavanelli had no involvement with inputting data to *Morningstar* or access to such data.⁹⁹ Zavanelli was also not aware that *Morningstar* even required disclosure of an SEC investigation until after the March 31, 2011, *Morningstar* was published.¹⁰⁰

This evidence does not support the Law Judge’s finding that the Respondents, especially Zavanelli, acted with scienter in failing to disclose the investigation.

V. SANCTIONS

A. ASSOCIATIONAL BAR AGAINST ZAVANELLI

A lifetime bar is an extraordinary remedy and the severest of sanctions that can be imposed under the Adviser’s Act as it deprives the individual of his livelihood and also deprives the investing public of the services of the barred individual. Before the SEC can impose that ultimate sanction, it must “explain why a less drastic remedy would not suffice.” *Steadman v. SEC*, 603 F.2d 1126, 1139 (5th Cir. 1979); *PAZ Securities, Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007).

The ID failed to provide the required explanation to justify a permanent bar against Zavanelli or indicate that a lesser sanction was considered. *Steadman, supra*, at 1140. The permanent bar is not justified by the evidence or the law and is punitive rather than remedial

⁹⁸ RX-38.

⁹⁹ ID,pg.55.

¹⁰⁰ ID,pg.32.

because a less comprehensive sanction would adequately serve the public interest. *In Re. Howard F. Rubin*, Release No. 35,179, 58 S.E.C. Docket 1426, 1994 WL 730446 at 1 (Dec. 30, 1994) (administrative proceedings are remedial, not punitive).

In addition, the *Steadman, supra*, factors weigh in favor of Zavanelli and do not support the imposition of the drastic sanction of permanent disbarment. The evidence did not demonstrate that Zavanelli acted with scienter regarding the six (6) magazine advertisements; two (2) investment newsletters; or the March 31, 2011, *Morningstar* and his conduct was, therefore, not egregious. *SEC v. Mannion*, 2014 WL 2957265, 6 (ND GA 2014). Zavanelli did not financially benefit from the claim of GIPS compliance in the magazine ads since ZPRIM received no clients from them, which further shows that his conduct was not egregious.¹⁰¹ *SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995). The 11 violations that the ID found spanned from October 2008 to May 2011 and are not recurrent under *Steadman, supra*. The six (6) magazine ads were qualitatively different from the two (2) investment newsletters and the *Morningstar* reports. The ID acknowledges that Zavanelli genuinely believed the newsletters were not advertisements¹⁰² and found that Bauchle, not Zavanelli, was responsible for the *Morningstar* reports.¹⁰³ These circumstances do not support a permanent bar against Zavanelli.¹⁰⁴

There is also no likelihood of future violations by Zavanelli. He has turned over 100% of his ownership in ZPRIM to his son, Mark Zavanelli, and has resigned as an officer and director.¹⁰⁵ His only function for ZPRIM is to provide investment advice to clients and manage

¹⁰¹ ID,pg.27.

¹⁰² ID,pg.54.

¹⁰³ ID,pg.55.

¹⁰⁴ See *SEC v. Metcalf*, Fed.Sec.L.Rep.P. 97,203 (S.D.N.Y. 2012) (no permanent bar for “highly egregious” conduct).

¹⁰⁵ RX-Supplement-53.

or co-manage ZPRIM's composites. If necessary, he is willing to accept a modified sanction that would preclude him from acting as an officer, director, or shareholder for ZPRIM but allow him to continue to provide investment advice under the firm's supervision. Finally, Zavanelli has acknowledged and accepted responsibility for his actions. He admitted that the magazine ads did not follow the Guidelines and hired his son Mark in October 2011 to take over as President and Chief Compliance Officer for ZPRIM. Zavanelli has recognized the need to turn over day to day management of ZPRIM to assure that GIPS and other compliance issues are properly addressed. His willingness to take on a lesser role and fewer responsibilities for ZPRIM is a clear acceptance of responsibility under *Steadman, supra*, and creates a deterrent against possible future violations.

A permanent bar against Zavanelli is not appropriate or necessary to serve the public interest since, under *Steadman, supra*, a lesser sanction will suffice.

B. CIVIL PENALTIES

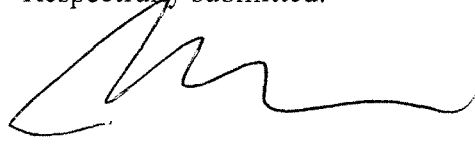
Since the evidence did not support a finding of scienter against the Respondents, Second Tier civil penalties are improper. However, to the extent the Commission determines the Respondents were responsible for a material misrepresentation or omission in a magazine ad, investment letter, or as to ZPRIM, a *Morningstar* report at issue and a violation of Section 206(2), 206(4), or Rule 206(4)-(a)(5) of the Adviser's Act was committed, then First Tier civil penalties would be appropriate. Zavanelli should have no responsibility for the *Morningstar* reports consistent with the ID's findings.¹⁰⁶

¹⁰⁶ ID,pg.55,56.

VI. CONCLUSION

The evidence demonstrated that Respondents disclosed investment performance results required by the Guidelines to prospective clients. The absence of these performance results from magazine advertisements and, if applicable, investment newsletters was, therefore, immaterial, did not establish any scienter by the Respondents and did not render ZPRIM's claim of GIPS compliance to be false or misleading as charged. Zavanelli has honorably served this country through his military service and has honorably served his clients by achieving stellar investment results as a portfolio manager. Technical compliance mistakes to follow the Guidelines, which Zavanelli has acknowledged and made significant attempts to correct, do not justify a permanent associational bar against him or Second Tier penalties against either Respondent. The Law Judge recognized that no harm resulted to the public from the Respondents' conduct, which ultimately supports a dismissal of the charges or imposing lesser sanctions.

Respectfully submitted.



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PHILIP J. SNYDERBURN, ESQUIRE

Florida Bar No. 0202592

E-Mail: psnyderburn@srslaw.net

K. MICHAEL SWANN, ESQUIRE

Florida Bar No. 0442410

E-Mail: mswann@srslaw.net

SNYDERBURN, RISHOI & SWANN, LLP

2250 Lucien Way, Suite 140

Maitland, Florida 32751

Telephone: 407-647-2005

Facsimile: 407-647-1522

Attorney for Respondents