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UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of

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

Respondents.

Administrative Proceeding
File No. 3-15263

RESPONDENTS, ZPR INVESTMENT MANAGEMENT, INC. AND MAX E. ZAVANELLI MOTION FOR RECONSIDERATION

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

Attorneys for Respondents

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UNITED STATES OF AMERICA
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SECURITIES AND EXCHANGE COMMISSION

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

RESPONDENTS' PETITION FOR RECONSIDERATION

Respondents, ZPR INVESTMENT MANAGEMENT, INC. ('ZPRIM") and MAX E. ZAVANELLI ("Zavanelli"), through their undersigned counsel and pursuant to SEC Rule 470, move for reconsideration of certain matters of record that were erroneously decided in the Commission's Opinion and Order dated October 30, 2015 and as grounds state:

I. EVIDENCE DOES NOT SUPPORT A FINDING THAT RESPONDENTS ACTED WITH SCIENTER[1]

The Commission erroneously determined as a matter of law that the Respondents acted with scienter regarding claims of compliance with the GIPS Advertising Guidelines ("Guidelines") in six (6) magazine advertisements published in 2008 and 2011 and allegedly made in the April and December 2009 ZPRIM investment newsletters. The evidence also supported no finding that ZPRIM acted with scienter by failing to disclose a pending SEC investigation in a *Morningstar* report the period ended March 31, 2011.

[1] Citations to the transcript are noted as TR-__ and to the Initial Decision as ID-___. Citations to the exhibits offered by the Division of Enforcement ("Division") and the Respondents are noted as DX-__and RX-__, respectively.

Scienter must be proven by 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)].

Many sanctions imposed against the Respondents including the industry bar against Zavanelli and second tier civil penalties require a finding that they willfully violated the law. A finding of willfulness requires no intent to violate the law but instead, intent to commit an act which constitutes a violation of the law. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000).

Therefore, if the evidence demonstrated that Respondents did not intend to commit acts that violated the Investment Advisors Act of 1940 ("Advisors Act"), then the sanctions imposed by the Commission were erroneous and must either be reduced or eliminated.

A. 2008 MAGAZINE ADVERTISEMENTS

Respondents placed advertisements with *Smart Money* magazine in October, November and December 2008 that did not comply with the Guidelines. The greater weight of the evidence, however, established that despite its non-compliance, Respondents' conduct was not willful or carried out with any degree of scienter.

Prior to running these advertisements, ZPRIM previously placed advertisements with *Smart Money* in January, February and April 2008 and with *Kiplinger* magazine in February 2008. These advertisements included period to date, 5 years of annualized returns and other periods for ZPRIM's Small Cap Value ("SCV") composite.[2] These performance returns complied with the Guidelines and the Administrative Law Judge ("ALJ") determined that Respondents committed no violations of the Advisors Act prior to April 9, 2008.[3]

[2] DX-21,pgs.1-4.

[3] ID-pg.60.

The format used by ZPRIM to place the fall 2008 *Smart Money* advertisements changed from what had been previously followed but there was no evidence that Zavanelli designed those ads or even saw them before they were published. E-mails introduced as RX-46 show several prospective ads being considered by ZPRIM for the fall of 2008. These e-mails were sent primarily between David Sappir ("Sappir")[4] and Ted Bauchle[5] ("Bauchle") and clearly show that Sappir designed the ads. Zavanelli was not copied on these e-mails and even though Sappir instructed Amy Bauchle, another ZPRIM employee, to show the ads to Zavanelli, there was no evidence to suggest he ever saw them. Zavanelli testified that he had instructed Bauchle to follow the same ad format for the upcoming fall 2008 ads that ZPRIM had used to place the earlier 2008 ads. TR-1413,1414. Two ads Sappir prepared followed this instruction but the format that eventually was chosen for the fall 2008 ads was actually Sappir's favorite[6].

Zavanelli's unrebutted testimony stated that he did not review the fall 2008 ads until February 2009 during the SEC's onsite examination of ZPRIM and he was out of the country when these advertisements ran. TR-1415,1418-1420. Before the October 2008 ad was placed, Zavanelli also testified that he had an urgent call from the ad formatter who informed Zavanelli the ad was loo long and would need editing. TR-1418,1419. Zavanelli's participation in this telephone conversation does not demonstrate that he reviewed the ad format before it ran or knew the 2008 fall advertisements would not comply with the Guidelines. His testimony with the ad formatter focused on retaining language in the ad footnote that included a claim of GIPS compliance by ZPRIM. *Id.* However, this isolated conversation hardly supports the Commission's erroneous finding that Zavanelli knowingly approved "ZPRIM's false claims of GIPS compliance in the 2008 fall advertisements". Zavanelli's familiarly and involvement with GIPS that the Commission relied on for its scienter finding is not relevant since the evidence showed

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[4] Sappir was a marketing consultant engaged by ZPRIM.

[5] Bauchle was responsible for calculating performance returns for ZPRIM composites.

[6] RX-46; Exhibit RX-48 also demonstrates Sappir wanted to use the performance returns that appeared in the 2008 *Smart Money* fall ads while Zavanelli had instructed his staff to calculate performance returns for ZPRIM's SCV composite for 1,3,5 and 10 year periods versus the bench mark indexes through August 31, 2008. Had these performance returns been included, the fall 2008 *Smart Money* ads would have complied with the Guidelines.

Zavanelli did not prepare the fall 2008 *Smart Money* ad format and did not review or approve of these advertisements before they were placed.

The Opinion's finding that Zavanelli separately agreed that the fall 2008 advertisements were submitted to him is factually erroneous and misconstrues the evidence. Opinion,pg.8. Zavanelli's testimony acknowledged ZPRIM changed its ad format in the fall of 2008 after it had experienced poor performance earlier in the year but again, this does not establish he even saw the new ad format or approved it. He specifically stated he did not approve the change or see the fall 2008 ads until after they were placed.[7]

The Commission's reliance on Bauchle's testimony about discussions he and Zavanelli had about including 1, 3 and 5 years of annualized performance returns in the 2008 fall advertisements is also inadequate to support a finding of scienter. First, Zavanelli denied speaking with Bauchle[8] about that topic and there was no written communication introduced to support Bauchle's position. Bauchle also testified he had never witnessed Zavanelli doing anything dishonest which negates that Zavanelli acted with scienter.[9]

Second, Zavanelli and not Bauchle requested performance returns that satisfied the Guidelines to be prepared in September 2008 when the fall *Smart Money* advertisements were being discussed. RX-48. In addition, Bauchle's September 2008 e-mail[10] raising the GIPS requirement of 1, 3, and 5 year annualized returns was not directed to Zavanelli but instead to Ruth Ann Fay ("Fay").[11] It is unclear from this e-mail if Bauchle understood what performance returns GIPS required but there is no evidence that Zavanelli ever received this correspondence. The Commission's reliance on this evidence for its scienter finding against the Respondents is, again, insufficient and erroneous.

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[7] TR-1500.
[8] TR-1479.
[9] TR-268.
[10] DX-46;DX-142.
[11] In September 2008, Fay served as ZPRIM's Chief Compliance Officer.

The evidence established that Zavanelli lost control of the 2008 fall *Smart Money* advertisements and told the ad formatter to "do what you can"[12], which could support a finding of negligence since the advertisements admittedly did not comply with the Guidelines. The greater weight of the evidence, however, does not support a finding of scienter against the Respondents.

B. 2011 MAGAZINE ADVERTISEMENT

ZPRIM placed three advertisements[13] in 2011 at issue in this proceeding. For these advertisements, ZPRIM included certain performance tables previously prepared and published by *Pensions and Investment* magazine, a *Morningstar* periodical. Each of these advertisements included a claim of GIPS compliance by ZPRIM but did not include performance returns required by the Guidelines. Based on this alone, the Commission found that Respondents acted with scienter in placing the advertisements and violated the Advisors Act. The imposition of strict liability is contrary to well established case and therefore, clearly erroneous as a matter of law.

The violation of standards such as Generally Accepted Accounting Principles ("GAAP") or the Association for Investment Management and Research Standards ("AMIR"), the predecessor of GIPS, without more does not violate the law or create an inference of fraud. *See* In Re AFC Enterprises, Inc. Securities Litigation, 348 F.Supp.2d 1363, 1372 (N.D. GA. 2004); Riggs Inv. Mgmt. Corp. v. Columbia Partners, LLC, 966 F.Supp. 1250, 1262 (D.C. Cir. 1997) (violation of AMIR standard itself not actionable).

[12] TR-1418,1419.

[13] February and May 2011 issues of *Smart Money* and a 2011 March issue of *Barron's*. RX-15,17,19.

Ironically, the omitted performance results required by the Guidelines for these advertisements would have enhanced ZPRIM's claim as a top investment manager. Its International Global Equity and All Asian composites were outperforming their respective benchmarks[14] for every annualized period the Guidelines would have required.[15] Therefore, no basis exists for the Commission's finding that Respondents presented information in the 2011 advertisements which only showed ZPRIM in the best light.

A finding of scienter simply cannot stand without intent to deceive, manipulate or defraud. Ernst & Ernst v. Hochfelder, 425 U.S.185, 193 N.12 (1976). Omitting favorable performance results from the 2011 advertisements cannot support a finding of scienter against Respondents.

C. INVESTMENT NEWSLETTERS

The evidence was unrebutted and the ALJ properly found that Zavanelli genuinely believed that ZPRIM's monthly investment newsletters were not advertisements.[16] In November 2008, ZPRIM's GIPS verifier, Ashland Partners ("Ashland"), informed the firm that when performance results were shown and a claim of GIPS compliance was made in an investment newsletter, a GIPS disclosure presentation should be included or the Guidelines should be followed.[17] Since ZPRIM provided a copy of its GIPS disclosure presentation to existing and prospective clients, Zavanelli thought that ZPRIM was complying with Ashland's recommendation, and to include the GIPS compliant presentation again would be repetitive and

[14] RX-16,18,20.
[15] RX-4,pg.30.
[16] TR-1451,1452; Initial Decision,pg.54.
[17] DX-47.

burdensome.[18] He did not feel there was a need to send duplicate copies of the same information to existing or prospective clients.

Despite Zavanelli's disagreement with Ashland about whether the investment newsletter was an advertisement by definition, Ashland continued to prepare GIPS verification reports for ZPRIM throughout 2009. Therefore, the newsletter issue did not affect the overall clam of GIPS compliance by the firm[19] and Ashland never threatened to withdraw its GIPS verification reports over the investment newsletter issue.[20]

Thereafter, in March or April 2010, a telephone conversation occurred between Ashland representatives and Zavanelli to discuss the investment newsletter and the advertisement issue.[21] Following this call, an undated letter was sent to Bauchle by Nikola Feliz ("Feliz"), an Ashland senior manager, which recommended that ZPRIM either cease claims of GIPS compliance in the investment newsletter or comply with the Guidelines.[22]

The unrebutted evidence showed Zavanelli was not aware until 2011 that ZPRIM could satisfy Ashland's concern by simply stop claiming GIPS compliance in the newsletter and well after the April and December 2009 newsletters were published.[23]

Based upon the evidence and Zavanelli's belief and mental state in 2009 that the investment newsletter was not an advertisement, he and therefore, ZPRIM did not act with scienter regarding the two 2009 newsletters at issue.[24]

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[18] TR-1449,1450. *See also*, 2005 GIPS standards section O.A.11 (firms must provide prospective clients with a GIPS compliant presentation within the previous 12 months). DX-3,pg.8.
[19] RX-14.
[20] *Id.*
[21] TR-993,994.
[22] DX-52.
[23] TR-1457.
[24] RX-23,24.

D. *MORNINGSTAR* REPORT FOR THE PERIOD ENDED MARCH 31, 2011

In a *Morningstar* report for the period ended March 31, 2011, ZPRIM disclosed there was no pending SEC investigation, but it did not act with scienter.

The evidence established that Bauchle was solely responsible for submitting data to *Morningstar.*[25] He testified there were two parts of the *Morningstar* database he would upload information to. One part would be uploaded quarterly with new performance numbers and assets for ZPRIM while the second part was a questionnaire Bauchle would update annually.[26] It was the second part of the *Morningstar* report that included disclosure about whether ZPRIM was the subject of an SEC investigation.

Bauchle testified that when he uploaded data to *Morningstar*, he knew that if the SEC investigation question was answered "yes", then the date of a Pending SEC Investigation charge must also be provided.[27] He clearly did not believe that any disclosure of the SEC investigation needed to be made until the Order Instituting Proceedings ("OIP") was filed against the Respondents on April 4, 2013.[28]

Bauchle understood the *Morningstar* database when he was uploading information and did not act with any scienter for ZPRIM by honestly answering a question about a pending SEC investigation that *Morningstar* presented. The Commission's finding it was Zavanelli and not Bauchle who advanced this theory at the final hearing is not supported by the record and therefore, is factually erroneous. Bauchle may have been negligent in failing to update the

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[25] TR-269,270.
[26] TR-272.
[27] TR-284, 285; RX-38.
[28] TR-285.

Morningstar report for the period ending March 31, 2011, but he did not possess the requisite intent to act with scienter.

II. RESPONDENTS DID NOT MAKE MATERIAL MISREPRESENTATIONS IN 2008 AND 2011 MAGAZINE ADVERTISEMENTS OR IN ITS APRIL AND DECEMBER 2009 INVESTMENT NEWSLETTERS REGARDING COMPLIANCE WITH THE GUIDELINES

An investment advisor is charged with a fiduciary obligation to make full and fair disclosure of all materials facts when dealing with existing and prospective clients.[29] A fundamental objective of the GIPS standards is "full disclosure and fair representation of investment performance."[30]

The evidence presented demonstrated the Respondents satisfied and fulfilled those responsibilities through the dissemination of performance returns, GIPS compliant presentations and other marketing materials made available on ZPRIM's website and sent directly to prospective clients when the 2008 and 2011 magazine advertisements at issue were published.[31] These responsibilities were also carried out when the April and December 2009 ZPRIM investment newsletters were circulated.

The Commission misapplied the test of materiality announced by the U.S. Supreme Court in Basic v. Levinson, 4850 US 224 (1988) and other key decisions by not evaluating the "total mix" of information that ZPRIM provided.[32] Instead, the Commission adopted a bright line approach that focused on a narrow claim of GIPS compliance made in the magazine advertisements and allegedly in the two investment newsletters at issue to conclude the

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29 SEC v. Capital Gains Research Bureau, 375 U.S. 180, 194 (1963).

30 RX-3,pg.2.

31 RX-8,9,10,11,16,18,20.

32 *See* TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976); Mattrix Initiatives, Inc. v. Siracusano, 131 S.Ct. 1309, 179 L.Ed.2d 398 (2011).

Respondents made false and misleading statements of material fact that violated the Advisors Act. This approach is not supported by the holding in Basic or other decisions regarding materiality and the Commission's findings are, therefore, clearly erroneous.

A. 2008 MAGAZINE ADVERTISEMENTS

A misstatement or omission of fact is material if there is a

> "[S]ubstantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."

TSC Industries, Inc. v. Northway, Inc. 426 U.S. 438, 449 (1976).

The Commission's application of the materiality test, therefore, cannot stop at the 4 corners of each magazine advertisement at issue. When the fall 2008 ads were placed by ZPRIM, performance returns for its composites that complied with the Guidelines[33] were disclosed on its website along with a GIPS compliant presentation, bar chart performance results and significant other information about ZPRIM and its management.[34] In addition, the evidence demonstrated that ZPRIM, as part of its customary business practice, provided performance returns for its composites, GIPS compliant presentations and other marketing materials to prospective clients. This information was sent to prospective clients when the fall 2008 *Smart Money* advertisements were placed[35] and in addition to the ZPRIM website information, would be part of the total mix of information made available to determine materiality under Basic.

Sappir testified that every prospective client that responded to a ZPRIM advertisement and requested information would receive a package that included a brochure, a letter and track

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[33] TR-1056,1054.
[34] RX-8,9.
[35] RX-8-11.

record.[36] Exhibit RX-11 represented the information Sappir testified would be sent by ZPRIM to any prospective client that responded to an advertisement. Within this package of information, ZPRIM included a one page summary that showed period to date and 1, 3, 5 and longer periods of performance for ZPRIM's SCV composite as compared to its benchmark index, the *Russell 2000*.[37] The summary page in RX-11 that ZPRIM sent to a prospective client on August 12, 2008, disclosed the SCV composite significantly underperformed the *Russell 2000* from March 2007 through March 2008. The summary also disclosed that for the first quarter of 2008, ZPRIM's SCV composite was significantly underperforming both the *Russell 2000* and *SIP 500* benchmark indexes.

These types of disclosures with updated performance results would also have been sent to any prospective clients that responded to the *Smart Money* October, November and December 2008 advertisements.[38]

Besides this information, if a prospective investor wanted to open an account with ZPRIM, the evidence established that ZPRIM sent out a second package of information that included quarterly performance returns, SCV annualized tables[39] and a GIPS annual presentation[40].

The types of disclosures and the timing that such disclosures were made by ZPRIM to prospective clients when considered as a part of the total mix of information made available,

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[36] TR-1141-1145.

[37] Jean Cabot testified that ZPRIM's performance returns disclosed in Exhibit RX-11 complied with the Guidelines. TR-717,718.

[38] RX-10.

[39] This table was not prepared for ZPRIM's International Global Equity composite until March 31, 2009. *See* RX-10. The International Global Equity composite, however, was not included in the advertisements that ZPRIM placed in the fall of 2008. *See* DX-21,pgs.5-7.

[40] RX-10;TR-1192-1194.

supplemented and corrected the GIPS performance returns that were not included in the fall 2008 *Smart Money* advertisements at issue. The Commission's finding that actions taken by ZPRIM to only disclose corrected performance returns before the advertisements were placed fails to consider all of the evidence.

As described, the efforts made by Respondents to disclose accurate performance results that satisfied the Guidelines on the ZPRIM website and sent directly to prospective clients was an ongoing process, and not simply limited to a period before the fall 2008 advertisements were placed.[41] In addition, the performance information provided to prospective clients in the first package of information sent contained the same performance information disclosed by ZPRIM's GIPS compliant presentation. ZPRIM, therefore, did not wait to deliver its performance results until a prospective client wanted to retain ZPRIM as the Opinion mistakenly determined. Considering all of the evidence and applying the <u>Basic</u> materiality test, the Commission's finding that ZPRIM did not correct its false claim of compliance with the Guidelines is clearly erroneous.

The Commission's findings also overlook the testimony of Feliz, who was called by the Division and claimed to be a GIPS expert.[42] Feliz testified that a prospective client who viewed a ZPRIM advertisement could access its website and download a GIPS compliant presentation that had been verified by Ashland.[43] Feliz also testified that the ZPRIM website complied with

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[41] RX-8, 9,10,11,16,18,20.
[42] TR-1057.
[43] TR-1058.

the Guidelines and understood that ZPRIM provided all prospective clients with a copy of its GIPS annual disclosure presentation.[44]

Most importantly, Feliz testified that if a firm made a mistake in an advertisement and subsequently sent the required information to a prospective client, those efforts would cure the deficiencies in the advertisement and satisfy the GIPS requirements.[45] She further testified that when ZPRIM provided supplemental information to a prospective client responding to an advertisement that did not comply with the Guidelines; and the supplemental information contained disclosures that satisfied the Guidelines, then the deficiencies within the initial advertisement would be corrected.[46] Since ZPRIM provided performance returns for prospective investors that complied with the Guidelines, the claims of GIPS compliance contained within the fall 2008 *Smart Money* advertisements were not false and misleading when the total mix of information required by Basic is considered.

The Commission's reliance on the decision reached in SEC v. Morgan Keegan & Co. Inc., 678 F.3d 1233 (11th Cir. 2012), is misplaced and erroneous. There, Morgan Keegan failed to send customer disclosures that described risks related to auction rate securities. *Id.* at 1252. In addition, an SEC cease and desist order entered against Morgan Keegan required it to disclose on customer trade confirmations that written auction practices and procedures, which would have revealed the risks involved, was available on a specific webpage of the Morgan Keegan website. *Id.* at 1238. Morgan Keegan failed to identify the specific webpage and instead, simply directed customers to its website, which was not readily accessible. *Id.* at 1239-1240.

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[44] TR-1057,1065.

[45] TR-1064.

[46] TR-1077-1079;RX-15,16.

Morgan Keegan is distinguishable from the present case since ZPRIM sent all prospective clients sufficient information and disclosures about the firm's performance returns, while Morgan Keegan withheld material information from customers. In addition, Feliz testified that prospective investors could download GIPS compliant presentation from the ZPRIM website.[47] The website appeared in every advertisement ZPRIM placed and encouraged readers to access it for more information.[48] By contrast, it was disputed whether customers of Morgan Keegan could readily access the relevant risk disclosures that were only made available on the Morgan Keegan website and difficult to find.[49]

The Commission's reliance on Seaboard Inv. Advisors[50] is also not relevant. There, an advisor attempted to correct fabricated performance results disclosed to existing clients through a letter that was itself false and misleading. This in no way resembles the true and accurate performance results that ZPRIM provided to all prospective clients who responded to advertisements.

ZPRIM's disclosure of composite performance results that satisfied the Guidelines and other materials to prospective clients must as a matter of law be included in the total mix of information that the Commission evaluated in its findings.

B. 2011 MAGAZINE ADVERTISEMENTS

Materiality embraces the "significance the reasonable investor would place on the withheld or misrepresented information."[51] The role of materiality is "to filter out essentially

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[47] TR-1057-1058.

[48] *See e.q.*,DX-21.

[49] SEC v. Morgan Keegan at 1241.

[50] Investment Advisers Act, Release No. 1918, 54 SEC 1111, 2001 WL 23178 at *4, N.21 (Jan. 10, 2001).

[51] Basic v. Levinson, 485 U.S. 224, 240 (1988).

useless information that a reasonable investor would not consider significant, even as part of a larger mix of factors to consider in making his investment decision."[52]

The omission of information from the 2011 advertisements placed by ZPRIM was not material since their inclusion would have enhanced the positive results ZPRIM reported as a top money manager. This information, therefore, would not have been necessary for a reasonable investor when making an investment decision to become a client of ZPRIM. In addition, an incorrect claim of GIPS compliance, without more, is not significant to a reasonable investor as a matter of law under the Basic holding.

However, if the positive performance results achieved by ZPRIM's International Global Equity and All Asian composites were material, then their omission from the 2011 advertisements was corrected and remedied by actual disclosure of those results to prospective clients.[53]

When considering the total mix of information made available by ZPRIM and for the reasons otherwise discussed in this section, the claim of GIPS compliance made in the ZPRIM 2011 advertisements was not materially misleading. Accordingly, the Commission's finding that Respondents violated the Advisors Act by simply making a claim of GIPS compliance in those magazine advertisements is erroneous. Aaron v. SEC, 446 U.S. 680, 697 (1980) (deliberate dishonesty required to prove scienter).

C. INVESTMENT NEWSLETTER

As previously discussed and if a claim of GIPS compliance was made in the ZPRIM April and December 2009 investment newsletters, it was not materially misleading under the

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[52] *Id.* at 234.

[53] RX-16,18,20.

Basic decision. Prior to becoming an actual client of ZPRIM, the evidence established that prospective clients received investment performance results that complied with the Guidelines.

In addition, the evidence showed that all existing clients of ZPRIM were provided with an annual GIPS compliant presentation.[54] Feliz and other Ashland representatives informed the Respondents that recipients of the newsletter should receive a GIPS compliant presentation to satisfy the Guidelines, which is exactly what the Respondents did.[55]

Therefore, any GIPS deficiencies within these investment newsletters were corrected by Respondents and the Commission's findings that they violated the Advisors Act by publishing the newsletters is erroneous.

III. IMPOSING AN INDUSTRY BAR AGAINST MAX E. ZAVANELLI IS NOT IN THE PUBLIC INTEREST

Under decisional law of the Eleventh Circuit Court of Appeals[56], which would have jurisdiction over any appeal, Steadman v. SEC, 603 F.2d 1126, 1139 (5th Cir. 1979), is controlling. Steadman stands for the following propositions:

- The Commission has an obligation to explain why a less drastic remedy other than a permanent bar would not suffice.
- The Commission's decision may be overturned only if it is "without justification in law or . . . without justification in fact."
- A permanent exclusion from the industry is "without justification in fact" unless the Commission specifically articulates compelling reasons for such a sanction.

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[54] TR-373-375;ID-pg.12.

[55] A GIPS compliant presentation is only required to be provided to a prospective client every 12 months. RX-3,pg.8. A prospective client is defined by the GIPS Standards as a person or entity that is qualified to and expresses an interest in investing in a strategy. RX-4,pg.42.

[56] All Fifth Circuit decisions prior to October 1, 1981 have been adopted as binding precedent of the Eleventh Circuit. Bonner v. City of Prichard, 661 F.2d 1206, 1209 (11th Cir. 1981).

- It would be a gross abuse of discretion to bar an investment adviser from the industry on the basis of isolated negligent violations.

Zavanelli's conduct should be evaluated based upon the legal principle that states if a party elects to disclose material facts which are incomplete, the federal securities laws "implicate a duty to disclose whatever additional information is necessary to rectify the misleading statements." *See* Rowe v. Maremont Corp., 650 F.Supp. 1091 (N.D. Ill. 1986); Schlifke v. Seafirst Corp., 866 F.2d 935 (7th Cir. 1989) and the recent Opinion of the Commission issued In the Matter of: David F. Bandimere, Securities Act of 1933 Release No. 9972; Securities Exchange Act of 1934 Release No. 76308, Oct. 29, 2015 at pg.16.

The Commission determined that imposing an industry bar on Zavanelli would serve the public interest due to: his egregious conduct that involved a high degree of scienter; the transactions at issue were not isolated but rather recurrent; Zavanelli failed to recognize the wrongful nature of the conduct; his assurances against future violations was not sincere; and there is a likelihood his occupation as an investment adviser will present opportunities for future violations. *See* Opinion, pgs.38-43. Zavanelli disagrees with these conclusions because:

A. EGREGIOUSNESS

The conduct involves three advertisements placed by ZPRIM in the fall of 2008, three advertisements in 2011 and two ZPRIM newsletters published in 2009. The alleged egregious act related to ZPRIM's claim of being a GIPS compliant firm (which it was) in a footnote to each of the advertisements but failing to follow the Guidelines, which required performance returns to be formatted in a certain fashion. GIPS is a voluntary set of standards and need not be followed under the Advisors Act. Absent the claim of GIPS, the advertisements were not misleading,

deceptive, fraudulent, or manipulative under the Advisors Act. All performance data reflected in the advertisements was 100% accurate but the cardinal sin was failing to follow the voluntary Guidelines which are not part of the GIPS Standards and not a requirement of the Advisors Act. So if the egregious act was failing to provide a prospective client with information required by the Guidelines and then that information was subsequently provided to the prospective client before becoming a client of ZPRIM, is that egregious? The undisputed evidence showed the omitted disclosures regarding the firm's performance results as required by the Guidelines were subsequently provided to any party that responded to a ZPRIM advertisement before they became a client. Egregiousness suggests that the Respondents would continue to hide this information but the subsequent disclosures of performance made by ZPRIM entirely rebut this finding. The information provided also showed the firm was underperforming its benchmarks in 2008. *See* RX-10,11. ZPRIM's performance returns were ordered by Zavanelli to be communicated to prospective clients and were transparent, not opaque. It is not logical to conclude that if Zavanelli was ordering the firm's performance disclosures to be given to prospective clients before they became clients that his conduct was egregious. If Zavanelli was trying to hide this performance, he would never have given the order to provide all of the firm's performance, both good or bad, to prospective clients. Zavanelli, as the "boss", required that all performance data be posted on ZPRIM's web site so every client and prospective client would have access to the information and he required that every prospective client be given a GIPS compliant presentation before becoming a client of the firm. Finally, any prospective client that responded to an advertisement was sent a marketing package that contained all of the

performance data required by the Guidelines[57] and showed that in 2008 the firm was underperforming its benchmarks. To suggest that Zavanelli acted egregiously in promoting the alleged violations in ZPRIM's fall 2008 advertisements belies any logical interpretation.

This logic is equally applicable to the advertisements in 2011, which were nothing more than reprints of advertisements run in another investment publication. There is nothing inaccurate, deceptive, fraudulent or manipulative about these advertisements. If the claim of GIPS compliance had been omitted, there would be no basis for a violation of the Advisors Act. Once again, the performance ratings and *Morningstar* ratings about Zavanelli in the reprinted advertisements were 100% accurate. Further, if the omitted information required by the voluntary Guidelines had been included, it would have shown the ZPRIM composites were "crushing" their benchmarks. RX-16,18,20. So why would a firm supposedly mislead the public about its performance omit positive information in an advertisement that showed it was "crushing" its benchmarks? The only logical explanation is that the firm was simply reprinting an advertisement that showed that it was a top performer, which cannot be construed as "egregious"

The Opinion also concludes that two monthly newsletters out of 48 (2008 through 2011) were deceptive or fraudulent because the firm claimed to be GIPS compliant but failed to include the formatting performance required by the Guidelines. Once again, any performance numbers referenced in the two newsletters were 100% accurate. But the Opinion contends that claiming to be a GIPS compliant firm and not formatting performance according to the Guidelines, without more, renders the newsletters fraudulent under the Advisors Act. The ALJ found that

[57] RX-9, 10,11,16,18,20.

Zavanelli honestly did not believe the newsletters were advertisements, so based on this evidence, how is Zavanelli's conduct "egregious"?

Other factors weighing against a finding of "egregiousness" include no financial harm to the public or to any prospective investor, no benefit to Zavanelli since no prospective clients become clients based upon the advertisements.[58] The Opinion stated that Zavanelli's conduct harmed the market because "he disseminated false information regarding his firm's GIPS compliance and denied investors the ability to make direct comparisons between ZPRIM's performance and that of other investment advisers." Opinion,pg.39. But ZPRIM was GIPS compliant and its compliance had been continuously verified since the Guidelines are not part of the GIPS standards. In addition, prospective clients were given performance data relating to the firm's composites, which permitted comparisons with other investment advisers. These facts do not support a finding that Zavanelli's conduct was egregious.

B. SCIENTER

The Opinion found Zavanelli acted with scienter, which was then imputed to ZPRIM regarding the advertisements and newsletters at issue. First, Zavanelli was not trying to deceive, manipulate or defraud the public. If he were, he would never have identified the firm's website in the advertisements, which disclosed the performance data required by the Guidelines. The website was freely accessible to the public and required no registration or password for access. Second, Zavanelli would not have sent marketing packages to prospective clients showing the performance of the firm, which revealed in the fall of 2008 that the firm was underperforming its benchmarks. Third, Zavanelli would not have provided every prospective client with a GIPS

[58] ID-pg.50,n.38.

compliant presentation after sending the marketing packages but before they became clients of ZPRIM. Finally, in the October 2008 newsletter, which was on ZPRIM's website, Zavanelli would not have broadcasted how poorly he had performed as an investment adviser in 2008. The conduct of Zavanelli cannot be considered "reckless" which is "an extreme departure from the standards of ordinary care . . . and presents a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it." Opinion,pg.22. Zavanelli was discharging his obligations to ensure that prospective investors were given full and fair disclosure about the performance of ZPRIM **before an** investment decision was made. The Opinion acknowledges this fact on page 20:

> Although ZPRIM did send prospective investors it GIPS compliant presentation, it did not do so until investors received contracts to retain ZPRIM. **It would have been important to potential to investors to receive the information at issue to be able to compare performance numbers before they reached this advanced stage with ZPRIM.** (Emphasis Added).

There is nothing in the decisional law to suggest that truncated disclosure before an investment decision is made is inappropriate. In SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 201, the United States Supreme Court quoting Dean Shulman about disclosure in securities transactions stated, "What is required is 'a picture not simply of the show window, but of the entire store . . . not simply truth in the statements volunteered, but disclosure.'" Schulman, Civil Liability and Securities Act, 43 Yale L. J. 227, 242. In the present case the advertisements were the "show windows and the starting point in the process" but subsequent disclosures before the investment decision was made provided a view for prospective clients of the "entire store". More importantly, before this information was delivered, any prospective investor who inquired after reading an advertisement was sent a marketing package that showed the performance of the

firm and clearly revealed the firm was underperforming its benchmarks in 2008. TR-1190,1193;RX-11. These disclosures cannot support a finding of scienter against Zavanelli.

C. RECURRENCE

The 6 advertisements and 2 newsletters fall into three distinct categories and cannot be recurrent as found in the Opinion on page 40. First, were the 3 advertisements that ran in the fall of 2008. Thereafter, Zavanelli was advised by the SEC examiners in early 2009 of their concerns about these advertisements. Zavanelli then caused the firm to run 3 advertisements in 2009 and 10 advertisements in 2010. These advertisements included performance results required by the Guidelines that were omitted from the fall 2008 advertisements. In addition, the footnotes in those advertisements were corrected to reflect the firm had not been audited by Ashland. Thus, the advertisements placed after the fall of 2008 show that Zavanelli's conduct was not recurrent and complied with the issues raised by the examination staff.

The second category of advertisements consisted of 3 reprint advertisements that ran in 2011 which were separate and distinct from the earlier advertisements placed in the fall of 2008. The 2011 advertisements simply reprinted information published in another magazine that ranked certain fund managers including Zavanelli. The information in the advertisements regarding performance and his rankings were accurate.

The final category consisted of 2 newsletters that were posted on ZPRIM's website. The ALJ concluded that Zavanelli believed the newsletters were not advertisements and all of the performance information presented in the newsletters was accurate.

Finally, the Opinion recited the prior offer of settlement with the Commission by Zavanelli in 1987 but noted, "[W]e do not consider it part of Zavanelli's current misconduct . . ."

Opinion, pg.40. It is difficult to fathom how 1400 transactions at issue in SEC v. Benger, 64 F.Supp.3d 1136 (N.D. Ill. 2013), were deemed as not recurrent but three separate and distinct categories of 6 advertisements and 2 newsletters involved in the present case are recurrent.

D. NO RECOGNITION OF WRONGFUL CONDUCT

The Opinion also concluded that Zavanelli "does not genuinely recognize the wrongfulness of his conduct" which was based on a finding that "ZPRIM's claims of compliance with the Guidelines were false . . ." Opinion,pg.41. Zavanelli, however, has repeatedly acknowledged the advertisements did not comply with the Guidelines but the Guidelines are not, and specifically disavow that they are GIPS standards. The claim of GIPS compliance by ZPRIM was accurate under the GIPS standards and had been verified by Ashland. In addition, Feliz herself claimed to be an expert regarding GIPS and testified that failing to follow the Guidelines does not nullify or render void the firm's claim of compliance with the GIPS standards, if the firm has taken action to correct the mistakes. TR-954,1029,1069. Paragraph 4 of the OIP states, "The GIPS Standards require all advertisements that include a claim of compliance with GIPS and present performance results must adhere to the Guidelines." The statement is simply not true since it is not contained in the GIPS standards but rather in an appendix to the standards entitled "Guidelines". The appendix states, "The Guidelines do not replace the GIPS standards . . ." and "The Guidelines are mandatory for FIRMS that include a claim of compliance with the Guidelines in their advertisements." *See* RX-3,pg.33. None of the ZPRIM advertisements, however, claimed compliance with the Guidelines, only with the GIPS standards. When Zavanelli claimed compliance with GIPS in the advertisements, he honestly believed the statement was true since ZPRIM's compliance with GIPS standards had been

verified. With respect to the newsletters, Zavanelli testified that he did not believe they were advertisements and the ALJ believed him. The Opinion on page 42 also stated that because Zavanelli believed the claims of GIPS compliance were not actionable because "investors might have found the omitted information elsewhere shows a lack of understanding of the antifraud provisions that endangers the investing public." But if Zavanelli truly lacked this understanding, he would not have undertaken to provide all disclosures that a prospective investor needed to evaluate the firm. He permitted the investor to look at the "entire store" and not just the "window".

E. INADEQUACY OF ASSURANCES AGAINST MISCONDUCT

The Opinion also stated on page 42 that efforts to remove Zavanelli from an ownership and control position in the firm, hire outside consultants to review future advertisements and limit Zavanelli's role to simply provide investment advice, would not remove the risk of future misconduct. The Opinion stated that Zavanelli's involvement in ZPRIM's core business by providing investment advice was the danger. This finding ignores the exemplary track record of Zavanelli as an investment advisor. There have been no complaints, arbitrations or civil suits by customers alleging that his advice has been misleading or inadequate. There are no charges in the OIP that his investment advice to clients was misleading, deceptive, fraudulent, or manipulative. Further, there has been no claim that he breached his fiduciary duty to any client of the firm. The evidence was clear that Zavanelli's performance as an adviser has garnered some of the highest rankings by *Morningstar* and that he has more often than not, out-performed his peers as reflected in the 2011 advertisements at issue. There is no risk or danger to the public or the clients of the firm by permitting Zavanelli to provide core investment advice.

IV. REQUEST TO RECONSIDER FINDINGS OR CONCLUSIONS IN THE OPINION

These findings or conclusions in the Opinion do not have support in the record:

1. **Opinion, page 4**. "He (Zavanelli) also retains significant input into various other ZPRIM decisions, including GIPS compliance." There is no citation to the record for this conclusion. However, the testimony was clear that Zavanelli is not involved in the advertising or compliance for the firm. Mark Zavanelli, the President and CCO, reviews advertisements for accuracy and compliance, which are then sent to the verifier for review and comment. The advertisements are also provided to an outside, independent, investment advisory consulting firm for review and comment. Zavanelli is and will not be involved in this process to ensure all advertisements comply with the Guidelines. TR-1776.

2. **Opinion, page 13, footnote 37**. Opinion denies Respondents' Motion to Supplement the Record and finds the documents were not material. The supplemental documents clearly relate to the Steadman factors and show there is no likelihood of future violations and the firm has taken corrective measures.

3. **Opinion, page 20**. "Although ZPRIM did send prospective investors its GIPS-compliant presentations, it did not do so until investors received contracts to retain ZPRIM." No citation is provided for this conclusion and Sappir testified that if someone responded to an advertisement, a marketing package was sent which included performance data. *See* RX-11;TR-1192,1193. This information was provided before the GIPS compliant presentation was sent but contained the same performance results found in the GIPS-compliant presentation, and showed ZPRIM was underperforming its

benchmarks in 2008. The advertisements directed the reader to the firm's website which provided more performance data and until March 2010, included GIPS-compliant presentations. If someone continued to have interest in becoming a client, additional information was sent which included the GIPS-complaint presentation and other agreements required under the Adviser's Act. RX-10.

V. CONCLUSION

The Commission should reconsider Tier Two remedial sanctions assessed against the Respondents due to a lack of scienter and based upon the total mix of information provided by Respondents and either dismiss the charges raised in the OIP or reduce the remedial sanctions to Tier One. In addition, there should be no permanent bar of Max E. Zavanelli based upon the Steadman factors.

Respectfully submitted.

K. MICHAEL SWANN, ESQUIRE
Florida Bar No. 0442410
E-Mail: mswann@srslaw.net
PHILIP J. SNYDERBURN, ESQUIRE
Florida Bar No. 0202592
E-Mail: psnyderburn@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

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing instrument was filed on this 16th day of November, 2015, via facsimile and that the original and three copies of the same furnished by Federal Express, overnight delivery, to:

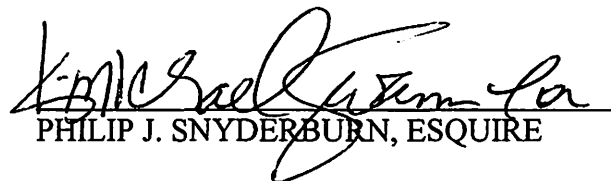
Securities and Exchange Commission
Office of the Secretary
100 F Street, N.E.
Washington, D.C. 20549-9303

and that a true and correct copy of the foregoing has been served via e-mail, facsimile and/or Federal Express on this date to:

Jill M. Peterson
Assistant Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

The Honorable Cameron Elliot
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Amie Riggle Berlin, Esquire
Senior Trial Counsel
Division of Enforcement
Securities and Exchange Commission
801 Brickell Avenue, Suite 1800
Miami, Florida 33131



PHILIP J. SNYDERBURN, ESQUIRE

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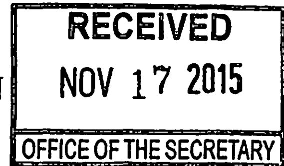
UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION



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

RESPONDENTS, ZPR INVESTMENT MANAGEMENT, INC. AND MAX E. ZAVANELLI'S RULES 154 CERTIFICATION AND CERTIFICATE OF SERVICE

TO

RESPONDENTS' MOTION FOR RECONSIDERATION

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

Attorneys for Respondents

RESPONDENTS, ZPR INVESTMENT MANAGEMENT, INC. ('ZPR") and MAX E. ZAVANELLI, by and through their undersigned counsel, hereby certify that Respondents' Motion for Reconsideration complies with length limitation in Rule 154 and the number of words is 6998.

Further, the undersigned hereby certifies that Respondents' Motion for Consideration was filed on this 16th day of November, 2015, via facsimile and that the original and three copies of Motion for Reconsideration were furnished by Federal Express, overnight delivery, to:

Securities and Exchange Commission
Office of the Secretary
100 F Street, N.E.
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and that a true and correct copy of the foregoing has been served via e-mail, facsimile and/or Federal Express on this date to:

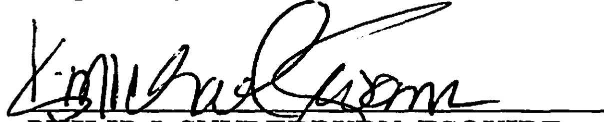
Ms. Jill M. Peterson
Assistant Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

The Honorable Cameron Elliot
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Amie Riggle Berlin, Esquire
Senior Trial Counsel
Division of Enforcement
Securities and Exchange Commission
801 Brickell Avenue, Suite 1800
Miami, Florida 33131

Dated this 16th day of November, 2015.

Respectfully submitted.



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

Attorneys for Respondents