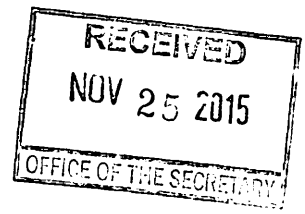
**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

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

**RESPONDENT'S REPLY TO THE DIVISION OF ENFORCEMENT'S OPPOSITION TO RESPONDENTS' MOTION TO STAY SANCTIONS**

Respondents, ZPR INVESTMENT MANAGEMENT, INC. and MAX E. ZAVANELLI, by and through the undersigned counsel, hereby reply to the Division of Enforcement's Opposition to Respondents' Motion to Stay Sanctions as follows:

Respondents, ZPR INVESTMENT MANAGEMENT, INC. and MAX E. ZAVANELLI, will reply to the Division of Enforcement's ("Division") Opposition to the Motion to Stay Sanctions ("Opposition") by focusing on the burden of the Respondents to demonstrate a likelihood of success on appeal, irreparable harm, injury to other parties and the public interest.

**LIKELIHOOD OF SUCCESS**

The Division argues that the Respondents cannot show a "substantial indication of probable success." Opposition, p.3. This claim is buttressed on the conclusion that the Commission "considered the total mix of information standard for determining materiality . . ." Opposition, p. 3. That conclusion is simply not accurate.

The evidence regarding the six print advertisements and two newsletters established that any prospective reader was directed to the firm's website which was a depository of all of the firm's performance data required by the GIPS Advertising Guidelines. The evidence also showed the performance numbers in the advertisements were accurate. The evidence also showed that any person who read the advertisements was sent a marketing package that contained the performance data required by the GIPS Advertising Guidelines. This performance data in 2008 showed the firm was underperforming its various benchmarks. Finally, if a prospective client desired to become a client of the firm, another package of information was sent. This package contained the GIPS compliant presentation which showed in 2008, the firm was underperforming its benchmarks and provided the data required by the GIPS Advertising Guidelines.

The Division contends, as did the Commission, that "[i]nvestors should not be required to search for additional information that a firm represents it has already provided through its claims of GIPS compliance." Opinion, p.19. Investors were not forced to "search" for the information, it was voluntarily provided by the firm. A cursory review of the representative marketing packages and GIPS compliant presentations demonstrates the information was not hidden or buried in a mound of documents. It was delivered in a forthright and direct manner. *See* marketing package, RX-11.

Finally, the Division and the Commission contend that "ZPRIM failed to 'adequately draw attention to it.'" Opposition, page 4, citing SEC v. Morgan Keegan & Co., In., 678 F.3d 1233, 1250, 1252 (11th Cir. 2012). The Morgan Keegan decision actually supports the arguments of the Respondents regarding materiality. There, the firm had sold large amounts of Auction Rate Securities ("ARS") in 2006, which resulted in a cease-and-desist order against the

firm by the Commission. The order required that the firm, in the future sale of ARS, to provide purchasers with numerous disclosures regarding the securities and how the auctions were conducted. Morgan Keegan at 1238, 1239. When the ARS market collapsed in 2008, the Commission commenced a civil enforcement proceeding against the firm for violating the federal securities laws in connection with sales that were made in 2007 and 2008. The Commission contended Morgan Keegan had misrepresented the ARS as being safe cash-equivalents with no liquidity risk. Morgan Keegan moved for summary judgment on the basis the facts failed to show a "material" misrepresentation. The district court granted the summary judgment and dismissed all counts against the firm. Morgan Keegan at 1243.

The Eleventh Circuit reversed the decision since the district court did not take into consideration the "mix" of information regarding the oral misrepresentations of four brokers at the firm. The court then analyzed whether the written disclosures rendered the oral misrepresentations immaterial. Morgan Keegan at 1250. The court stated "[t]he way information is disclosed can be as important as its content. Thus, in evaluating the effect of Morgan Keegan's written disclosures, we must consider not only the content of the written disclosures but also the way in which the disclosures were made." Morgan Keegan at 1250. The court then concluded the written disclosures were inadequate. "The oral misrepresentations at issue here were made directly to customer---investors who aver **they never received or knew about the written disclosures at the time of their purchases.**" Morgan Keegan at 1251 (emphasis added). The court concluded that "although Morgan Keegan produced adequate written disclosures in the ARS Manual and the ARS Brochure and gave the ARS Manual directly to customers in 2006, **there is no evidence that, during late 2007 and early 2008, Morgan Keegan directly gave**

**customers these written disclosures before or after customers purchased ARS."** Morgan Keegan at 1252, (emphasis added).

In the present action there is no evidence that there were any oral misrepresentations since the Division never called any prospective client as a witness. As a result, the analysis of "materiality" is limited to the written disclosures that were provided after the advertisements had run but before the investment decision was made. The evidence was overwhelming that all of the written disclosures regarding performance were given to every prospective investor unlike the purchasers in Morgan Keegan. The evidence also showed all of the performance data regarding the history of the firm was accurate. There is no evidence in the record to support the conclusion "investors had to search for additional information." There is no evidence in the record that supports the conclusion that the "Respondents failed to draw attention to it." The record is clear that full and fair disclosure of all material facts were provided to each and every prospective investor regarding the performance of ZPR before the decision to select the firm was made.

Any appeal of the matter will be heard before the Eleventh Circuit Court of Appeals and will be decided, ultimately, by the Morgan Keegan decision. The district court concluded the written disclosures of Morgan Keegan warranted summary judgment in favor of the firm. The Eleventh Circuit concluded that if the disclosures had been provided, these would have been adequate but the disclosures were not provided. As a result, there is a substantial likelihood of success on appeal as it relates to the six advertisements and two newsletters.

As to the likelihood of success regarding the two *Morningstar* reports based upon a finding of scienter, the Division fails to address the question raised by Commissioner PIWOWAR. During oral argument, he questioned counsel for the Division as to how can you

answer the question about an investigation when there are no "charges." Due to the unsatisfactory response, Commissioner PIWOWAR dissented with respect to a finding of scienter which is required for a violation of Section 206(1) of the Advisers Act. If one Commissioner believed there was no scienter, it is reasonable to infer the Eleventh Circuit could arrive at the same conclusion. Just as the district court in Morgan Keegan concluded that all material disclosures had been made warranting summary judgment for the firm. Additionally, the Division and the Commission conclude that since Max Zavanelli, and not Ted Bauchle, advanced this theory at the hearing it should be given no weight since his testimony is irrelevant because he was not involved with the *Morningstar* reports. Opposition, p.4. Who advanced the theory is totally irrelevant to the inquiry. The plain language on the form is determinative of the issue when it asked the following question – "Pending SEC Investigation Charge[s]." As Commissioner PIWOWAR noted in his questioning, how can you answer that when there are no charges?

**IRREPARABLE HARM**

The Division fails to place any weight on the substantial likelihood of success regarding the issue of materiality. There was full and fair disclosure of all material facts regarding the performance of the firm. Respondents have not speculated about financial harm. If the advisor of a small firm is barred after serving his client base for over 25 years, why would any client remain at the firm? This is not speculation but simply acknowledging the reality of the situation. As noted in the motion, this is a small firm ($164 million in assets with 105 clients). Barring the advisor and assessing $820,000 in financial penalties against the firm and the advisor will be the death knell for the firm.

## INJURY TO OTHER PARTIES

The record shows that there has been no financial harm to any member of the public or any client of the firm. It simply defies logic that granting the stay would cause harm to other parties when that harm or injury has not occurred.

## PUBLIC INTEREST

The Division contends the remedial sanctions were "tailored to protect investors from Respondents' serious repeated and willful misconduct." The argument ignores the fact that there has been no harm to the investing public. The Division also failed to call any client of the firm to support this contention. As the record reflected, the firm has had no complaints, arbitration proceedings, or civil suits filed by any client of the firm. The record demonstrated exemplary investment performance by the Respondents which will be lost absent a stay. It is in the public interest to protect the clients of the firm.

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

***Attorney for Respondents***

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing instrument was filed on this 25th 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:

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

PHILIP J. SNYDERBURN, ESQUIRE

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