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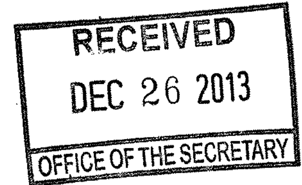

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15446

In the Matter of

J.S. OLIVER CAPITAL MANAGEMENT, L.P., IAN O. MAUSNER, AND DOUGLAS F. DRENNAN,

Respondents.

CHIEF JUDGE BRENDA P. MURRAY

THE DIVISION OF ENFORCEMENT'S PREHEARING BRIEF

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I. INTRODUCTION

This matter involves two distinct fraudulent schemes perpetrated by respondents J.S. Oliver Capital Management, L.P. ("J.S. Oliver"), a registered investment adviser, and its principal Ian O. Mausner ("Mausner"): the "cherry-picking" of favorable stock trades and the misuse of client "soft dollar" credits. This fraud caused millions of dollars of harm to the respondents' clients. Mausner, the founder of J.S. Oliver, personally benefitted from the fraud. As for respondent Douglas F. Drennan ("Drennan"), he is a long-time employee of J.S. Oliver, and he aided, abetted, caused and benefited from some of the misconduct involving the misuse of soft dollars.

J.S. Oliver provides investment management services to separately-managed client accounts and during the period at issue in this matter the firm also managed four affiliated hedge funds: J.S. Oliver Investment Partners I, L.P., J.S. Oliver Investment Partners II, L.P., J.S. Oliver Offshore Investments, Ltd. (collectively, the "J.S. Partners Funds"), and J.S. Oliver Concentrated Growth Fund ("Concentrated Growth Fund" or "CGF") (together with the J.S. Partners Funds, the "J.S. Oliver Funds"). The Concentrated Growth Fund began trading on June 1, 2008, the same day that Mausner began his cherry-picking scheme. Mausner is the founder of J.S. Oliver and served as its president, head portfolio manager, control person, and chief compliance officer during the period at issue. Drennan has been an employee of J.S. Oliver since 2004 except for a six-month period in 2008 when he worked as an analyst for a different investment adviser.

A. The "cherry-picking" scheme

The evidence will show that, from June 2008 to November 2009 (the "relevant period"), Mausner and J.S. Oliver engaged in the fraudulent allocation of profitable trades to favored accounts, a scheme known as "cherry-picking." As part of this scheme, Mausner and J.S. Oliver disproportionately allocated favorable trades to six accounts, including J.S. Oliver's four

affiliated hedge funds, while allocating unfavorable trades to the accounts of three clients, including a charitable foundation and an elderly widow. Mausner directly benefitted from his cherry-picking scheme because he and his family were personally invested in the favored hedge funds.

Mausner also benefited indirectly from the scheme because the favorable trade allocations boosted CGF's performance, which allowed J.S. Oliver to charge and receive inflated fees from GCF. Mausner inflated that fund's performance through the cherry-picking of profitable trades, and then touted the fund's performance in mass emails to current and prospective investors, recommending that they invest in CGF. In November 2008, for example, in an effort to solicit investors in CGF, Mausner touted to current and prospective clients that CGF had gained almost 13% during a period that the S&P declined by 17%. Mausner's cherry-picking scheme caused harm of $10.9 million to the three disfavored clients during the period covered by the Division's allegations.

Mausner and J.S. Oliver were able to cherry-pick favorable trades because Mausner waited to allocate trades to specific accounts until after the close of the day on which the trades were made. By waiting to allocate the trades, Mausner knew with certainty which trades had been profitable and which had been unprofitable from the time they were executed until the close of trading. The evidence will show with an extraordinarily high degree of statistical certainty that the divergent performance between the favored and disfavored accounts was the result of cherry-picking by Mausner and J.S. Oliver. Indeed, basic and generally-accepted statistical methods will show that the likelihood that the observed difference in allocation between profitable and unprofitable trades to the favored and disfavored accounts arose by chance is approximately 1 in one quadrillion (10^{15}), and that the extreme bias in trade allocations is due to cherry-picking by Mausner and J.S. Oliver. The evidence will also show that the bias in

allocations cannot be explained by any purported difference in trading strategies, such as options trading or "defensive-oriented" strategies, nor can it be explained by market volatility.

B. The fraudulent misuse of "soft dollars"

The evidence will also show that Mausner and J.S. Oliver misused over $1.1 million in client soft dollar credits from January 2009 through November 2011. Soft dollars are client commission credits. They are generated when an investment adviser negotiates with a broker-dealer to pay commissions that exceed an amount normally paid to compensate the broker for executing trades (*i.e.*, "best execution"). The excess of the negotiated commission over the normally charged best execution rate generate the "soft dollar" credits, which the adviser is allowed to use, in certain circumstances, to cover expenses borne by the adviser for the benefit its clients. For example, an adviser may execute several trades with one of its brokers that would normally cost $5,000 in commission; but instead, the adviser agrees to pay the broker $6,000 in commission, generating a $1,000 soft dollar credit that the adviser can use to cover permissible expenses, like research analysis provided by outside research analysts. Soft dollar credits are not intended, and are not supposed to be used, to pay for an adviser's regular expenses, like salaries or in-house research, and certainly not for personal expenses.

Because soft dollar credits are generated through the higher commissions paid by clients, soft dollars are assets of the clients, not of the investment adviser. The Securities Exchange Act of 1934 ("Exchange Act") places specific restrictions on the use of soft dollars. Specifically, under the "safe harbor" provision of Section 28(e) of the Exchange Act, advisers may use soft dollars for limited reasons, such as paying for "brokerage and research services" for an investment adviser's managed accounts, and only under certain circumstances, without breaching its fiduciary duties to clients. Soft dollars may also be used to pay for other legitimate expenses of an investment adviser if the use of soft dollars is in the clients' best interest and is disclosed to

clients with sufficient specificity so that the client can understand what benefit is obtained with its assets.

Mausner and J.S. Oliver used soft dollar credits in several ways that were not in the best interests of and not disclosed to their clients, and that often benefited Mausner financially. For example, J.S. Oliver received reimbursement from one of its soft dollar brokers of $329,365 in soft dollars for a payment J.S. Oliver had made to Mausner's ex-wife pursuant to their divorce agreement. To document this payment's purported eligibility for soft dollar reimbursement, Mausner and Drennan materially altered certain language from Mausners' marital settlement agreement to make it appear that the payment was for employment services, and not to discharge Mausner's personal obligation.

Mausner also misused client soft dollar credits to pay excessive "rent" to an entity he owned. J.S. Oliver used a portion of Mausner's residence in San Diego and paid monthly rent to Mausner's company. When Mausner realized that the broker would grant his request to use client soft dollar credits to pay J.S. Oliver's rent, he raised the rent from $6,000 to $15,000 per month in the span of four months, and then he funneled more than $200,000 in excess "rent" payments directly to his personal bank account. Mausner also improperly used client soft dollar credits to pay more than $40,000 in maintenance and other fees on his personal timeshare at the St. Regis luxury hotel in New York City. J.S. Oliver, Mausner and Drennan also financially benefitted through improper soft dollar payments made to a purported research firm that Drennan owned, Powerhouse Capital Management, Inc. ("Powerhouse"), purportedly for independent research but which actually paid Drennan's salary for various services he provided to J.S. Oliver. The respondents used soft dollar credits to pay Drennan, through Powerhouse, approximately $480,000 for purported research, including a $100,000 bonus. They did so even though Drennan

was not an outside research analyst but rather a full-time J.S. Oliver employee, and thus ineligible for soft dollar payments.

None of these uses of client soft dollar credits was in the best interest of or disclosed to J.S. Oliver's clients. Each improper use constitutes a breach of fiduciary duty by Mausner and J.S. Oliver and a violation of the investment adviser antifraud and general antifraud provisions of the federal securities laws.

The evidence also will show that Drennan aided, abetted and caused Mausner's and J.S. Oliver's soft dollar fraud violations. Drennan, at Mausner's direction, materially altered a document and submitted other false information to support the misuse of soft dollar credits to pay Mausner's divorce settlement with his ex-wife. Drennan also approved at least three of Mausner's inflated rent invoices while knowing that Mausner was transferring the excess "rent" payments to Mausner's personal account. Drennan also knew that he was receiving soft dollar payments as a purported research analyst under the safe harbor of Section 28(e), when in reality he was an employee of J.S. Oliver and thus not eligible to have his salary and bonuses paid with client soft dollars.

At the administrative hearing, the Division of Enforcement ("Division") will prove by a preponderance of the evidence that Mausner and J.S. Oliver violated the antifraud and investment adviser fraud provisions of the federal securities laws, and that Drennan aided, abetted and caused their violations in connection with the soft dollar misuses.[1] The Division will also prove that J.S. Oliver violated, and Mausner aided, abetted, and caused its violations of, the books and records and written policies and procedures provisions of the Investment Advisers Act

[1] Proof by preponderance of the evidence is the standard in administrative proceedings. *In the Matter of Sandra K. Simpson*, AP File No. 3-9458, 2002 SEC Lexis 1278, *57 (May 14, 2002); *Steadman v. SEC*, 450 U.S. 91, 102-03 (1980).

of 1940 ("Advisers Act"), and that Mausner and J.S. Oliver violated the false Form ADV provisions. The Division will further show that the public interest requires the imposition of significant sanctions against Mausner, Drennan, and J.S. Oliver for their violations. The Division seeks against each respondent a cease-and-desist order, disgorgement plus prejudgment interest, and third-tier civil penalties, and additionally seeks revocation of J.S. Oliver's status as an investment adviser and securities industry bars against Mausner and Drennan.

II. STATEMENT OF FACTS

A. Mausner and J.S. Oliver Engaged in Cherry-Picking

Compelling evidence will show that, from at least June 2008 through November 2009, Mausner and J.S Oliver engaged in fraudulent trade allocation by "cherry-picking" favorable trades for J.S. Oliver's affiliated hedge funds and two other accounts (the "favored accounts") to the detriment of three client accounts (the "disfavored accounts").[2] Mausner's and J.S. Oliver's cherry-picking scheme caused losses of $10.9 million to the disfavored accounts during the period at issue, and benefited Mausner, who had invested in the hedge funds and who received performance fees based upon the inflated performance of the hedge funds, particularly CGF.

1. Mausner and J.S. Oliver were able to allocate trades after the close of trading, and sometimes as late as the next day, after they learned which trades had been profitable and which had been unprofitable

In perpetrating the cherry-picking scheme, Mausner and J.S. Oliver executed block trades in omnibus accounts at several broker-dealers, including Instinet, LLC ("Instinet") and BTIG,

[2] The favored accounts were the four J.S. Oliver Fund accounts, Status-One Investment Partners, and the Taube Family Trust; the disfavored accounts were the Coleman Trust, the Sapling Foundation, and Chelsey Capital. The Sapling Foundation is a charitable foundation that runs the "TED" conferences, and the trustee of the Coleman Trust account is Harriet Coleman, an elderly widow. Chelsey Capital is a profit sharing plan and its sole member is Stuart Feldman, a purported limited partner of J.S. Oliver.

LLC ("BTIG"). J.S. Oliver reported the block trades to its prime broker, BNP Paribas Prime Brokerage, Inc. ("BNP"), and then allocated the shares among the client accounts through BNP's online system. BNP's online system allowed Mausner and J.S. Oliver to delay allocating trades until after the close of trading, or sometimes until the following day, allowing Mausner first to determine which securities had appreciated or declined in value before he allocated the trades to specific client accounts. All of the trade allocations were performed either by Mausner personally, or by J.S. Oliver employees at Mausner's explicit direction.[3]

2. Compelling statistical evidence will show that Mausner and J.S. Oliver cherry-picked favorable trades for the favored accounts, to the detriment of the disfavored accounts

Extremely strong statistical evidence will show that Mausner and J.S. Oliver systematically allocated a disproportionately large share of profitable equity trades to six "favored" accounts (which included the J.S. Oliver Funds) and systematically allocated a disproportionately large share of unprofitable equity trades to three "disfavored" accounts.[4] The statistical evidence will show convincingly that the disparities in Mausner's and J.S. Oliver's allocation of trades were the result of cherry-picking, and not the result of random variations. Indeed, the evidence will show that, using basic and generally-accepted statistical methods, the probability that the disparity in performance between the favored and disfavored accounts arose by chance is approximately 1 in one quadrillion (10^{15}).

[3] J.S. Oliver failed to maintain records of any purported pre-allocation of trades Mausner claims he created on a spreadsheet before executing the block trades with the executing brokers. In addition, from May 2008 to mid-2011, J.S. Oliver failed to maintain, as required, trade memoranda with daily trade details.

[4] The favored and disfavored accounts collectively accounted for approximately 98% of J.S. Oliver's total trading volume during the period in which the cherry-picking occurred.

Mausner's primary methodology to accomplish the cherry-picking was to allocate disproportionately to the favored accounts trades that increased in value during the trading day, and allocate trades that decreased in value during the day to the disfavored accounts. By waiting until after the trading day had concluded, Mausner knew which trades had been profitable and which had been unprofitable before he was required to allocate them. Mausner also cherry-picked the most favorable trades when there were multiple trades in a single security over the course of the day.

The evidence will also show that the greater the profitability of a trade, the more likely that Mausner would allocate it to one of the J.S. Oliver Fund accounts and the less likely that he would allocate it to one of the disfavored accounts. For example, the J.S. Oliver Investment Partners II account was one of the favored accounts. During the relevant period, 10.71% of shares from all trades were allocated to this account. But a much larger allocation of shares from the most profitable transactions – 14.09% of shares – was allocated to the account.[5] In contrast, the account of the Sapling Foundation, one of the disfavored accounts, was allocated 11.31% of shares from all trades but only 5.31% of shares from the most profitable transactions during the relevant period.

The effect of Mausner's and J.S. Oliver's cherry-picking is reflected in the dramatically different first-day returns realized by the favored and disfavored accounts.[6] The evidence will

[5] For purposes of this example, the "most profitable" trades are defined as the top 25% most profitable trades. The evidence will show that the disparity between favored and disfavored accounts is even more pronounced if only the top 10% most profitable trades are considered.

[6] The first-day return for a stock purchase is the percentage difference between the closing price for the stock on the day it was purchased and the price at which it was purchased. For example, a stock purchased at $100 per share would have a positive first-day return of 1% if the stock closed at $101 per share on the day it was purchased, and a first-day loss of -1% if the stock closed at $99 per share. The same methodology is used for stock sales. To account for differences in trade sizes, first-day returns are calculated on a dollar-weighted basis.

show that the favored accounts realized an average first-day return of 0.12%, which correlates to an annualized return of 35%, and the disfavored accounts suffered an average first-day loss of -1.31%, or a loss of 96% on an annualized basis.

3. The differences in performance are not due to different trading strategies between the favored and disfavored accounts, and are not due to options trading by the favored accounts

The evidence will also show that that the vast disparity in performance between the favored and disfavored accounts cannot be attributed to the favored and disfavored clients investing in different stocks because, for the most part, the accounts traded in the same stocks. In fact, stocks traded by the three disfavored accounts as a group accounted for 97% of the dollar volume of trading in the favored accounts during the relevant period. The statistical evidence will show that, after excluding stocks that were not traded by the disfavored accounts, the statistical likelihood of cherry-picking persists at extremely high levels.

Similarly, the purported use of options trading, "defensive" or "short-oriented" trading strategies for the CGF account, "buy-and-hold" strategies, or market volatility effects cannot account for the difference in performance between the favored and disfavored accounts. First, the evidence will show that options trades constituted less than 1% of the total dollar volume of trading by the disfavored accounts during the relevant period and, consequently, any impact of options trading on the statistical significance of the results would be *de minimis*. More importantly, the effect, if any, of options trading is irrelevant: the conclusion that the disfavored accounts were harmed by cherry-picking in *equities* stands, whether or not the disfavored accounts traded in *options* as well. Second, the evidence will show that the result does not change when the analysis (1) controls for defensive strategies, either by excluding from the analysis CGF, which purportedly employed a defensive strategy, or by excluding short sales across all accounts, (2) controls for long-term, buy-and-hold strategies by excluding stocks that

were held for at least ten days, or (3) controls for market volatility by excluding from the analysis trades on highly volatile market days. In every case, the statistical evidence of cherry-picking remains overwhelmingly high.

4. The cherry-picking benefited Mausner directly because he invested in the favored accounts, and indirectly because he earned performance fees based on the performance of CGF

Although the Division does not need to prove motive, the evidence will show that Mausner had a strong financial motive to prefer the favored accounts over the disfavored accounts. First, Mausner and his family were personally invested in some of the J.S. Oliver Funds and benefited directly by their inflated performances. For CGF in particular, as of the end of 2008, the aggregate value of Mausner's and his related-party entities' investments accounted for $1.4 million of the $7.9 million invested in CGF.

Second, unlike the disfavored accounts, the J.S. Oliver Funds paid a 20% performance fee to J.S. Oliver.[7] Although the three J.S. Partners Funds were subject to pay performance fees, those fees would be paid only to the extent that the net asset value of the fund had increased from its previous highest level (*i.e.*, the fund's "high water mark"). By June 2008, the J.S. Partner Funds had performed poorly and were well below their high-water marks, delaying when, if ever, J.S. Oliver could earn performance fees from them. Consequently, Mausner formed CGF in June 2008 and over the next five months emailed current and prospective investors to tout CGF's inflated positive monthly returns and make a "strong" recommendation to invest in CGF.[8]

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[7] The disfavored separate client accounts generally paid lower fees or had caps on the performance fees J.S. Oliver could earn (e.g., Coleman's advisory agreement did not provide for the payment of any performance fees; the Sapling Foundation's advisory agreement did permit performance fees but they were capped at 1% of the assets in the account).

[8] J.S. Oliver failed to maintain originals of Mausner's email messages and, consequently, it is unclear precisely who or how many recipients received them.

For example, relying on the profits generated through his cherry-picking scheme, a November 2008 email sent by Mausner to induce investments in CGF touted that CGF had gained almost 13% when the S&P declined almost 17% during the same period. CGF paid J.S. Oliver a performance fee of 20% of fund profits, and also paid J.S. Oliver a management fee of 2% of the fund assets, whereas the J.S. Partners Funds paid a 1% management fee. For 2008, CGF paid J.S. Oliver over $212,000 in performance fees.

B. Mausner and J.S. Oliver Misused Client Soft Dollar Credits, and Drennan Aided, Abetted and Caused Their Violations

1. J.S. Oliver accrued client soft dollar credits from trading hedge fund and other client accounts

The evidence will show that, beginning in January 2009, Mausner and J.S. Oliver misused over $1.1 million of client assets in the form of soft dollar credits. Soft dollars are client commission credits that are generated when an investment adviser negotiates to pay commissions that exceed what is necessary to compensate the broker for the trade execution. These soft dollar credits can later be used, under certain circumstances, to pay for services that benefit the adviser's clients. Because clients' commission dollars generate the soft dollar credits, soft dollars are assets of the clients, not of the investment adviser.

Investment advisers may use soft dollars in accordance with Section 28(e) of the Exchange Act, which provides a "safe harbor" that allows investment advisers to use client funds to purchase "brokerage and research services" for their managed accounts under limited circumstances without breaching their fiduciary duties to clients. But many expenses are

specifically excluded from the scope of Section 28(e), including salaries (including in-house research staff), rent, and travel expenses.[9]

Soft dollars may also be used to pay for other legitimate expenses of an investment adviser if such use is in the best interest of clients and express disclosures are made to clients with sufficient specificity so that the client can understand what benefit purportedly is obtained with its soft dollars. Such disclosure is required because the use of soft dollars is otherwise an undisclosed use of clients' assets and, if such conflict is not adequately disclosed, it is a breach of fiduciary duty when an adviser puts its interests ahead of its clients' interests.

Through equity and options trading, J.S. Oliver earned and used client soft dollar credits primarily at two broker-dealers: Instinet and, to a lesser extent, BTIG. Although J.S. Oliver used an omnibus account at Instinet under its own name, the trading that generated the soft dollar credits at issue was conducted on behalf of its four hedge funds and some of its separate client accounts. Under J.S. Oliver's oral soft dollar agreement with Instinet, Instinet agreed to a soft dollar credit typically fixed at $0.0225 for every $0.03 of brokerage commissions generated per share by the majority of J.S. Oliver's equity trades. For options, the soft dollar credit varied; for example, on a particular trade in January 2009, for every one share of option contracts traded, $2 went towards soft dollar credits and $1 went to Instinet for execution.

J.S. Oliver used client soft dollar credits for expenses that fell both within and outside the Section 28(e) safe harbor. But the total amount of soft dollars skyrocketed during the period when the respondents misused the credits. In 2009 and 2010, Instinet, at J.S. Oliver's request, paid almost $2.5 million in soft dollars on J.S. Oliver's behalf. By comparison, in 2007 and

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[9] *See* Securities and Exchange Commission, 17 C.F.R. Part 241, Commission Guidance Regarding Client Commission Practices under Section 28(e) of the Securities Exchange Act of 1934, July 18, 2006, pp. 61-62.

2008, when J.S. Oliver's soft dollar arrangements with other broker-dealers paid only for expenses that fell within the Section 28(e) safe harbor, J.S. Oliver used just $106,643 in soft dollar credits.

2. J.S. Oliver's misleading soft dollar disclosures

The evidence will show that, on multiple occasions, Mausner and J.S. Oliver used soft dollar credits in a manner not in the best interest of and not disclosed to their clients, and frequently to benefit Mausner financially.

Mausner and J.S. Oliver provided misleading disclosure of their use of soft dollar credits in J.S. Oliver's Forms ADV, Part II, filed March 30, 2007 and March 3, 2009, for its separate accounts, and in the offering memoranda for its four hedge funds. Mausner conducted the final review and approval of J.S. Oliver's Forms ADV, Part II and offering memoranda. Each of the documents had language disclosing that soft dollars may be used for research and brokerage payments under the Section 28(e) safe harbor. The Forms ADV, Part II and offering memoranda contained additional limited soft dollar disclosure as described below.

a) J.S. Oliver's Forms ADV

For the separate accounts, J.S. Oliver's Form ADV, Part II (which was provided to existing and prospective separate client accounts), filed March 30, 2007, provided that clients' soft dollars may be used for:

> "expenses of and travel to professional and industry conferences and hardware and software used in the General Partner's administrative activities ... [and] may even include such 'overhead' expenses as telephone charges, legal and accounting expenses of the Investment Manager or General Partner and office services, equipment and supplies."

J.S. Oliver amended the 2007 disclosure in its Form ADV, Part II, filed March 3, 2009, but the amendment actually narrowed the soft dollar disclosure. In particular, in the March 2009 filing, J.S. Oliver disclosed only that it may use soft dollars earned from trading in the hedge funds, with absolutely no disclosure provided for the use of soft dollars generated from trading in its separately managed client accounts. J.S. Oliver did not revise any language concerning the allowed uses of soft dollars to include additional permissible uses for soft dollars consistent with how it was actually using soft dollars at that time.

b) The J.S. Partners Funds' offering memoranda

The soft dollar disclosures in the J.S. Partners Funds' offering memoranda were identical to the disclosure in J.S. Oliver's 2007 Form ADV, Part II. The J.S. Partners Funds' disclosures provided that soft dollars may be used for:

> "expenses of and travel to professional and industry conferences and hardware and software used in the General Partner's administrative activities … [and] may even include such 'overhead' expenses as telephone charges, legal and accounting expenses of the Investment Manager or General Partner and office services, equipment and supplies."

c) The CGF offering memorandum

The disclosures in the CGF offering memorandum provided, in relevant part, that soft dollars may be used for:

> "evaluating potential investment opportunities (including travel, meals and lodging related to such evaluation) … and may even include such 'overhead' expenses as office rent, salaries, benefits and other compensation of employees or of consultants to the Investment Manager …."

The CGF offering memorandum was only received by investors in CGF, not by J.S. Oliver's separate clients or investors in the J.S. Partners Funds.

3. Respondents provided Instinet only with the CGF offering memorandum

J.S. Oliver, through Drennan, provided Instinet's soft dollar department with only the CGF offering memorandum to support respondents' requests for reimbursement and payment using soft dollar credits.[10] Drennan did so even though J.S. Oliver also earned soft dollar credits through the trades of individual clients and the J.S. Partner Funds, and the separate client accounts and J.S. Partners Funds investors did not receive the CGF offering memorandum. Respondents thereby provided Instinet with a disclosure document that would give the firm the most leeway in its use of soft dollar credits, even though they knew that the soft dollar disclosures in the J.S. Partner Funds' offering memoranda and Forms ADV were narrower than those in the CGF offering memo, and that the CGF offering memorandum was not provided to J.S. Oliver's separate clients or to investors in the J.S. Partners Funds. As described below, however, even the CGF offering memorandum did not adequately disclose the expenses for which J.S. Oliver sought and received soft dollar payments.

4. Mausner and J.S. Oliver used client soft dollar credits for expenses that were not in their clients' best interests, nor disclosed to clients or fund investors

The evidence will show that Mausner and J.S. Oliver used more than $1.1 million of client soft dollar credits to pay for expenses that were not in their clients' best interests and were not disclosed to its hedge funds' investors or to its separate client accounts. As described below, Mausner used soft dollars: (1) to pay more than $329,000 to his ex-wife as part of their divorce

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[10] While Instinet paid soft dollar credits for non-Section 28(e) items, BTIG's agreement with J.S. Oliver provided that it would not pay for items outside the Section 28(e) safe harbor. Thus, the limited soft dollar disclosures in the Forms ADV, Part II, and in the Funds' offering memoranda were irrelevant to the soft dollar requests J.S. Oliver made to BTIG.

settlement; (2) to pay $300,000 in inflated "rent" on his home, with Mausner pocketing $200,000 in excess payments; (3) to pay over $40,000 in maintenance and other fees on Mausner's personal timeshare at the luxury St. Regis Hotel in New York; and (4) to pay Drennan $480,000 in salary and bonuses.[11]

a) Mausner and J.S. Oliver did not disclose their use of client soft dollar credits to pay Mausner's divorce settlement with his ex-wife

In June 2009, Instinet, at J.S. Oliver's request, reimbursed J.S. Oliver $329,365 using soft dollar credits for a payment J.S. Oliver had made to Mausner's ex-wife, Gina Kloes, based on Mausner's misrepresentations to Instinet that the payment was for "employee compensation." Although Ms. Kloes had been a J.S. Oliver employee in 2004 and 2005, she was not an employee of the firm after 2005, and was under no obligation to perform any work for J.S. Oliver as of December 31, 2006. The evidence will show that J.S. Oliver paid Ms. Kloes the $329,365 not as part of any employment agreement, but rather to discharge Mausner's personal obligation pursuant to the Mausners' divorce agreement.

(1) Mausner and Ms. Kloes's divorce

Mausner and Ms. Kloes were married from 1994 until their 2005 divorce. As part of their divorce, Mausner and Ms. Kloes entered into a marital settlement agreement, which provided for a series of payments Mausner would cause J.S. Oliver to pay Ms. Kloes "in lieu of" spousal support. The parties' 2005 agreement included provisions requiring Mausner to cause J.S. Oliver to pay Ms. Kloes an annual "salary" for January 2007 to December 2010, for which Ms. Kloes did not have any obligation to perform any work for J.S. Oliver, as well as payments

[11] Mausner will likely argue that some of these misuses of soft dollars were approved by J.S. Oliver's counsel. The evidence will show that counsel did not provide any such approvals and that, even if they had, it would not have relieved respondents from their obligation to disclose fully and accurately their soft dollar uses to their clients.

for a country club membership, a nanny for their children, a weekly housekeeper, and a part-time assistant for Ms. Kloes.

Mausner, however, did not cause J.S. Oliver to make the agreed-upon payments. In 2009, as a result of their ongoing disagreements, Mausner and Ms. Kloes entered into a revised martial settlement agreement. In the 2009 settlement agreement, Mausner agreed that J.S. Oliver would pay his ex-wife a lump-sum payout of $214,500 plus payroll taxes (totaling $329,365), in exchange for Ms. Kloes waiving her right to the entire amount due under the parties' 2005 agreement and "any spousal support that may be due" Ms. Kloes.

(2) Mausner, assisted by Drennan, requested that Instinet pay Mausner's ex-wife with client soft dollar credits

In May 2009, Mausner and Drennan requested that Instinet reimburse with client soft dollar credits J.S. Oliver's payment to Ms. Kloes. In submitting the soft dollar request, Drennan initially misrepresented to Instinet that the reason for the payment was that J.S. Oliver was hiring Ms. Kloes as a consultant and then misrepresented that J.S. Oliver planned to keep Ms. Kloes on payroll as an employee. Mausner, in a May 26, 2009 email to Instinet, misrepresented to Instinet that Ms. Kloes had remained an employee since 2005 and that J.S. Oliver planned to make a lump sum payment to Ms. Kloes for the "remaining salary" due to her through 2011. Contrary to both of their representations, although Ms. Kloes performed minimal tasks for J.S. Oliver between 2006 and 2008, J.S. Oliver did not employ Ms. Kloes after 2006, and she certainly was not an employee in 2009.

After receiving the May 26 email from Mausner, Instinet requested an in-person meeting with him. On June 1, 2009, two Instinet representatives met with Mausner at J.S. Oliver's office. During the meeting, the Instinet representatives requested a copy of the employment agreement between J.S. Oliver and Ms. Kloes that required the purported lump sum payout of salary.

To satisfy Instinet's requests for adequate documentation for the soft dollar reimbursement, Drennan, at Mausner's direction, pasted an excerpt of the 2005 marital settlement agreement onto J.S. Oliver letterhead to be forwarded to Instinet. Mausner, however, instructed Drennan to alter materially the language in the excerpt to hide that the payout was in fact Mausner's personal obligation to Ms. Kloes. Specifically, Mausner instructed Drennan to represent to Instinet that the agreement requiring the payment was between J.S. Oliver and Ms. Kloes, when, in reality, both the 2005 and 2009 marital settlement agreements were between Mausner and his ex-wife. In addition, Mausner instructed Drennan to change the language of the excerpt to delete references that were clearly personal in nature, including the country club memberships, nanny, weekly housekeeper, and Ms. Kloes's part-time assistant. The fact that respondents altered documents to procure the payment using soft dollars shows a high level of scienter.

The evidence will show that Drennan drafted the excerpt as instructed by Mausner, even though Drennan knew that (1) the lump sum payment obligation arose from the Mausners' 2009 marital settlement agreement; (2) Ms. Kloes was not working for, and had no obligation to work for, J.S. Oliver in exchange for the payment; and (3) Mausner planned to provide the excerpt to Instinet in support of using soft dollar credits to reimburse J.S. Oliver for the payment. Drennan also approved the payment on J.S. Oliver's behalf in Instinet's online soft dollar system. In June 2009, Instinet reimbursed J.S. Oliver the $329,365 using J.S. Oliver's clients' soft dollar credits.

Mausner and J.S. Oliver did not disclose to their clients or fund investors that they would use soft dollar credits to pay Mausner's ex-wife pursuant to Mausner's divorce agreement. None of J.S. Oliver's disclosures addressed such use. The payment to Ms. Kloes was neither salary nor a consulting fee. Ms. Kloes was not obligated to do any work for the firm in exchange for the payment and she did not perform any work during the relevant timeframe. Moreover, even if

the facts were different and the payment legitimately could be considered "salary," the use of soft dollars for salary was never disclosed to J.S. Oliver's separate clients (in the Forms ADV, Part II) or investors in the J.S. Partners Funds (in the offering memoranda). Only the CGF offering memorandum disclosed salary as a potential use of soft dollars.

b) Mausner used client soft dollars to pay excessive, undisclosed "rent" to an entity he owned, and funneled excess cash to his personal bank account

(1) Mausner and J.S. Oliver used soft dollars to pay purported rent on a home his company owned

Beginning in 2005, J.S. Oliver used a portion of Mausner's personal residence in a residential neighborhood in San Diego to conduct its business. At the time, the home was owned by JO Samantha LLC ("JO Samantha"), an entity owned by Mausner. J.S. Oliver's business occupied a little more than half of the home, and Mausner used some of the home for personal use, including bedrooms for him and his children. The monthly mortgage on Mausner's home was approximately $5,445 per month.

Mausner unilaterally decided the monthly rent that J.S. Oliver would pay to JO Samantha. Through 2008, J.S. Oliver paid $6,000 per month in rent, which JO Samantha used to pay the full mortgage on Mausner's home and other small expenses. JO Samantha had no other business.

In mid-February 2009, Drennan, on behalf of J.S. Oliver, requested that Instinet make J.S. Oliver's rent payments to JO Samantha with client soft dollar credits beginning, retroactively, with the January 2009 payment. Instinet thereafter began paying J.S. Oliver's rent to JO Samantha with soft dollars.

(2) After Instinet began paying Mausner's rent with soft dollars, Mausner dramatically increased the monthly rent, from $6,000 to $15,000 per month

Once Instinet began paying rent on the home with soft dollars, Mausner quickly and dramatically increased the monthly rent. J.S. Oliver had been paying rent of $6,000 per month to JO Samantha through February 2009. But once Instinet began paying the rent using client soft dollars, Mausner retroactively raised the rent for January and February 2009 from $6,000 to $10,000 per month, a 67% increase. After Instinet paid the $10,000 rent, JO Samantha repaid to J.S. Oliver the two $6,000 payments it had previously received for those months. Drennan, on J.S. Oliver's behalf, approved the payment of at least three inflated rent invoices in Instinet's soft dollar system. He did so even after Mausner had told him that the ability to pay rent with soft dollars was a factor in Mausner's decision to increase the rent.

Just four months later, in July 2009, Mausner again raised the monthly rent, this time to $15,000, and J.S. Oliver instructed Instinet to pay that amount monthly in rent to JO Samantha. Thus, in a span of only a few months, Mausner increased the monthly rent from $6,000 to $15,000, a 150% increase. Instinet thereafter began paying JO Samantha $15,000 in monthly rent. In 2009 and 2010, Instinet paid JO Samantha a total of $300,000 in rent payments using J.S. Oliver's clients' soft dollar credits.

Mausner arbitrarily increased the rent Instinet paid to his company using soft dollars. He had no basis to increase J.S. Oliver's rent other than to personally enrich himself. Beginning in May 2009, and continuing on an almost monthly basis, Mausner directed J.S. Oliver employees, including Drennan, to transfer any excess cash from JO Samantha to his personal bank account. Mausner received over $200,000 from such distributions. Prior to the use of client soft dollar credits to pay rent, Mausner had not previously received a distribution from JO Samantha.

The disclosures in the J.S. Partner Funds' offering memoranda and the Forms ADV, Part II did not include payments for rent or personal use of property. Although the disclosures contained a reference to "overhead," that was described as "telephone charges, legal and accounting expenses, . . . office services, equipment and supplies." Moreover, none of the disclosure documents informed clients or Fund investors that Mausner could receive cash from the soft dollars paid to JO Samantha. While the disclosure in the CGF offering memorandum allowed the use of soft dollar credits to pay rent, any rent legitimately payable by the firm should have been an amount representing the *pro rata* portion of the house dedicated and used for the advisory business and not the entire residence. There was no disclosure that J.S. Oliver would pay excessive rent that would inure to the personal benefit of Mausner. Based on the disclosures, investors would not reasonably expect that payments using soft dollars for rent would fully cover and greatly exceed Mausner's obligations on his personal residence.

c) **Mausner used client soft dollars to pay maintenance fees on his personal timeshare at a luxury hotel in New York City**

Mausner also used client soft dollar credits to pay more than $40,000 in maintenance and other fees on his personal timeshare. Mausner's family trust owned a fractional interest in a two-bedroom condominium unit at the luxury St. Regis Hotel in New York, which gave him a fixed week and 21 additional days annually at the hotel. Under the timeshare contract, Mausner was obligated to pay real estate taxes, maintenance, and other fees on this unit. In January 2009 and December 2009, J.S. Oliver submitted invoices to Instinet for $19,128 and $20,966, respectively, claiming that the expenses were for travel to evaluate "potential investment opportunities."

The disclosures in J.S. Oliver's Forms ADV, Part II and J.S. Partner Funds' offering memoranda provided that soft dollars may be used to reimburse travel expenses related to conferences only. Here, there is no evidence that Mausner attended any conferences in

connection with his use of the timeshare. Similarly, the CGF offering memorandum allowed soft dollar payments for "travel, meals and lodging" only if it was connected to a "potential investment opportunity," but there is no evidence that Mausner used the timeshare to evaluate potential investment opportunities. But even if the facts were different and Mausner did use the timeshare for conferences or evaluating investment opportunities, the timeshare's maintenance and other fees cannot legitimately be considered travel or lodging expenses, and they were not disclosed to J.S. Oliver clients as possible soft dollar uses. Moreover, Mausner regularly used the timeshare for personal use, including family visits, but he made no effort to apportion the personal versus purported business use of the timeshare. Mausner and J.S. Oliver did not disclose to clients or fund investors that they would use client soft dollars to pay the entire maintenance bill, totaling over $40,000, on Mausner's personal timeshare.

d) J.S. Oliver and Mausner misused client soft dollar credits for payments to Drennan by falsely claiming the payments were pursuant to the Section 28(e) safe harbor

In 2009 and 2010, J.S. Oliver used client soft dollar credits to pay Drennan approximately $480,000 for purported research pursuant to the Section 28(e) safe harbor, including a $100,000 one-time bonus. J.S. Oliver represented to Instinet and to BTIG that Powerhouse Capital was an outside, independent research firm that provided research and analysis to J.S. Oliver. In reality, Powerhouse Capital was Drennan, effectively a full-time J.S. Oliver employee, who performed multiple J.S. Oliver duties in addition to research. Drennan drafted the Powerhouse Capital invoices, and he and others at J.S. Oliver sought payments for Powerhouse Capital using soft dollars from Instinet and BTIG.

Drennan had previously worked for J.S. Oliver from its inception in 2004 through May 2008, after which he worked at a different firm for six months. In January 2009, he returned to J.S. Oliver and essentially resumed his prior job at the firm, performing both research and

analysis and a multitude of other J.S. Oliver duties. But because Mausner did not want to pay Drennan, Drennan was not hired as a J.S. Oliver employee; instead, Drennan and Mausner agreed to have Drennan's salary paid entirely with client soft dollars.

The evidence will establish that Drennan functioned as a *de facto* employee of J.S. Oliver and performed duties other than providing research. For example, during 2009 and 2010 Drennan provided the following non-research related work for J.S. Oliver at Mausner's request:

- Drennan served as one of the primary contacts for J.S. Oliver in its soft dollar relationship with Instinet, including initiating the soft dollar account and approving, on J.S. Oliver's behalf, Instinet's initial payments to Powerhouse Capital, the reimbursement to J.S. Oliver for the payment to Ms. Kloes, and at least three of Mausner's inflated "rent" payments.
- Drennan was also listed as a trader on the Instinet account opening documents and signed a BTIG documents as a "trader" for J.S. Oliver, giving him trading authorization on the J.S. Oliver account.
- He communicated directly with brokerage firms regarding J.S. Oliver trades, including executing and allocating trades and problem-solving issues.
- Drennan worked full time in J.S. Oliver's office as the so-called "team leader," in which capacity Drennan oversaw much of J.S. Oliver's internal accountant's work, including review of J.S. Oliver's monthly cash reports, and sent employees weekly emails with tasks to perform.
- Drennan also participated in executive coaching sessions provided to all J.S. Oliver employees.

The evidence will show that Mausner considered Drennan a J.S. Oliver employee and team member. Indeed, Mausner, when referring to Drennan's return to J.S. Oliver after six

months at another firm, stated that anyone would "jump at [the] opportunity" to "get a great employee back for free." When conducting business with outside brokerage firms, Drennan communicated on J.S. Oliver's behalf and not as an independent research provider. Additionally, although Drennan may have conducted some research for J.S. Oliver, there is no evidence to support how much time he spent doing so because he did not track his time and he did not provide written reports to Mausner.

Importantly, the soft dollar payments Drennan received as Powerhouse Capital would have been improper even if made to him as an employee. The use of soft dollars for salary was never disclosed to J.S. Oliver's separate clients or investors in the J.S. Partners Funds. Only the CGF offering memorandum disclosed salary as a potential use of soft dollars; the Forms ADV, Part II and the J.S. Partners Funds' offering memoranda did not. Moreover, the fact that the respondents contrived to use soft dollars under the Section 28(e) safe harbor to pay Drennan provides strong evidence of their scienter.

III. LEGAL ARGUMENT – LIABILITY

A. Mausner and J.S. Oliver Violated, and Drennen Aided, Abetted and Caused Their Violations of, the Antifraud and Investment Adviser Fraud Provisions of the Federal Securities Laws

The evidence will show that Mausner and J.S. Oliver, by engaging in the conduct described above, violated the investment adviser antifraud provisions of Sections 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder, and the antifraud provisions of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The evidence will also show that Drennan aided, abetted and caused J.S. Oliver's violations of the investment adviser fraud and antifraud provisions relating to soft dollar practices.

Although the specific provisions of the antifraud and investment adviser fraud provisions differ slightly, the factual underpinning of the violations of each of these provisions is the same: (1) Mausner's and J.S. Oliver's cherry-picking of profitable trades for favored accounts, to the detriment of the disfavored accounts, and (2) their misuse of client soft dollars, which was aided, abetted, and caused by Drennan.

1. Mausner and J.S. Oliver violated Section 206(1) and (2) of the Advisers Act

Section 206 of the Advisers Act establishes a federal fiduciary standard for investment advisers, including the obligation to exercise the utmost good faith in dealing with their clients, to disclose to their clients all material facts, and to employ reasonable care to avoid misleading their clients. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). Specifically, Section 206(1) of the Advisers Act prohibits an investment adviser from using instruments of interstate commerce to employ any device, scheme, or artifice to defraud any client or prospective client. Section 206(2) makes it unlawful for an adviser to use instruments of interstate commerce to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Section 206(1) requires a showing of scienter; Section 206(2) does not. *Steadman v. SEC*, 603 F.2d 1126, 1134-35 (5th Cir. 1979). Scienter may be established by showing extreme recklessness. *See SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990) (en banc).

Both J.S. Oliver and Mausner are investment advisers. Section 202(a)(11) of the Advisers Act defines an "investment adviser" as a "person who, for compensation, engages in the business of advising others, ... as to the value of securities or as to the advisability of investing in, purchasing, or selling securities...." J.S. Oliver is registered as an investment

adviser with the Commission. It provides investment advice to its clients – separate accounts and hedge funds – by selecting investments for them. It receives compensation from its clients in the form of management and performance fees. Mausner has been the president and head portfolio manager of J.S. Oliver since 2004, when he founded the advisory firm with his now ex-wife and another purported limited partner. From at least mid-2008 through 2011, Mausner was the control person of J.S. Oliver and he made all of the investment decisions for J.S. Oliver's clients. Mausner received a salary and distributions from J.S. Oliver's profits, and thus received compensation in connection with giving investment advice. Therefore, Mausner is an investment adviser under Section 202(a)(11). *See In the Matter of John J. Kenny, et al.*, SEC Rel. No. IA-2128, n. 54 (May 14, 2003) (an individual associated with investment adviser entity "may be charged as a primary violator under Section 206 where the activities of the associated person cause him or her to meet the broad definition of 'investment adviser.'").

As discussed below, J.S. Oliver and Mausner violated Sections 206(1) and (2) in two distinct ways: by cherry-picking profitable trades for favored accounts and by misusing client soft dollar credits.

a) Mausner and J.S. Oliver violated Sections 206(1) and 206(2) by cherry-picking profitable trades to benefit favored accounts, to the detriment of disfavored accounts

The evidence will show that Mausner and J.S. Oliver breached their fiduciary duty to their clients by misallocating trades to the detriment of the three disfavored clients. *See, e.g., In the Matter of Ark Asset Management Co., Inc.*, Advisers Act Rel. No. 3091 (Sept. 29, 2010) (settled administrative proceeding in which adviser knowingly or recklessly allocated profitable trades to the proprietary accounts at the expense of certain client accounts and did not disclose

the scheme to its clients). The harm to the disfavored clients was substantial: more than $10.9 million over eighteen months.

The evidence will show that Mausner acted with a high level of scienter in perpetrating his cherry-picking scheme. He knew or was reckless in not knowing about the allocation of favorable trades because, after market close or even the next day, he personally apportioned trades among J.S. Oliver client accounts, or directed others to do so. Mausner's scienter is imputed to J.S. Oliver. *See SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1089 n.3, 1096-97 n. 16-18 (2d Cir. 1972) (company's scienter imputed from individuals who control it). Mausner engaged in the cherry-picking to enrich himself, both directly as an investor in the favored hedge fund accounts, and indirectly as the recipient of higher fees as a result of the inflated performance of CGF.

Mausner's and J.S. Oliver's cherry-picking constitutes an egregious breach of their fiduciary duty to their clients. Their fraudulent trade allocation scheme, directly benefiting themselves to the detriment of their clients, is one of the most extreme examples of placing the adviser's interests ahead of those of their clients, and unquestionably constitutes violations of the investment adviser fraud provisions. *See, e.g., SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1303-04, 1308-09 (S.D. Fla. 2007) (defendants' cherry-picking scheme operated as a device, scheme, or artifice to defraud, and as a fraud or deceit upon investors, "[i]n nearly every conceivable way"); *In the Matter of James C. Dawson*, 2010 SEC Lexis 2561, *8-9 (July 23, 2010) (Commission Opinion) (in evaluating an investment adviser's bar, the Commission found that the adviser exploited his position of trust and disregarded his fiduciary duties by cherry-picking profitable trades for his own benefit).

b) Mausner and J.S. Oliver violated Sections 206(1) and 206(2) of the Advisers Act by misusing client soft dollar credits

Investment advisers have a duty "to eliminate, or at least expose, all conflicts of interest which might incline [them] - consciously or unconsciously - to render advice which was not disinterested." *Capital Gains*, 375 U.S. at 194; *see also In the Matter of Renaissance Cap. Advisors, Inc.*, Advisers Act Rel. No. 1688 (Dec. 22, 1997) (settled administrative proceeding involving an adviser that failed to disclose its soft dollar arrangement, thereby violating Sections 206(1) and (2)). "The fundamental obligation of the adviser to act in the best interest of his client also generally precludes the adviser from using client assets for the adviser's own benefit or the benefit of other clients, at least without client consent." *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934* ("*Commission Guidance*"), 2006 SEC Lexis 1625, *4, n.3 (July 18, 2006) (citation omitted). Investment advisers "must disclose client commission arrangements as material information," *id.* at *45, or they may be held liable for violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Advisers Act. *See, e.g.*, *In the Matter of Sage Advisory Services LLC, et al.*, Advisers Act Rel. No. 1954, 2001 SEC Lexis 1482 (July 27, 2001) (settled administrative proceeding).

Section 28(e) of the Exchange Act "establishes a safe harbor that allows money managers to use client funds to purchase 'brokerage and research services' for their managed accounts under certain circumstances without breaching their fiduciary duties to clients." *Commission Guidance* at *3. Importantly, there are several categories of expenses that do *not* qualify for the Section 28(e) safe harbor. These include "expenses for travel, entertainment, and meals associated with attending seminars, and travel and related expenses associated with arranging trips to meet corporate executives, analysts, or other individuals who may provide eligible

research orally..., salaries (including research staff), rent..." *Commission Guidance* at *61-62. The Section 28(e) safe harbor "does not excuse a money manager from [its] disclosure obligations[,]" but only from "obtaining the lowest available commission rate where the amount of commission is reasonable in relation to the value of brokerage and research services provided." *Sage Advisory Services LLC*, 2001 SEC Lexis 1482, *10, n.7 (citation omitted).

Importantly, the Commission has noted that "[m]ore detailed disclosure is required when the adviser receives products or services that fall outside the scope of Section 28(e)." *Id.* at *10; see also *Commission Guidance* at *45. Indeed, soft dollar payments must be disclosed to clients "with enough specificity so that clients can understand what is being obtained." Securities and Exchange Commission 17 C.F.R. Part 241, Release No. 34-23170, Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, April 28, 1986.

From 2009 through November 2011, J.S. Oliver and Mausner breached their fiduciary duty to their clients, both individuals and the hedge fund investors, by using client soft dollar credits for several purposes that were not in their clients' best interests, were not disclosed to individual clients or J.S. Oliver's hedge fund investors and, even if they had been disclosed, were excessive in amount. These soft dollars uses were outside the Section 28(e) safe harbor and thus not only needed to be disclosed, but should have been disclosed with enough specificity so that J.S. Oliver's clients and hedge fund investors could understand exactly what their soft dollars were being used for. Respondents never made such disclosures.

First, Mausner and J.S. Oliver did not disclose to their clients or hedge fund investors that they would use client soft dollar credits to pay substantial funds to Mausner's ex-wife pursuant to a divorce agreement "in lieu of spousal support," and such payments were not in the best interest of J.S. Oliver's clients. None of J.S. Oliver's disclosures addressed such use. The

payment to Ms. Kloes was neither salary nor a consulting fee, because Ms. Kloes was not obligated to do any work for the firm in exchange for the payment and, the evidence will show, Ms. Kloes did not perform any work during the relevant timeframe. Moreover, even if the facts were different and the divorce payment to Ms. Kloes could be considered "salary", the payment would be considered excessive given the lack of work she performed. In addition, the Forms ADV, Part II, which were received by J.S. Oliver's individual clients, and the J.S. Partners' offering memoranda, which were received by investors in the J.S. Partners Funds, did not disclose that client soft dollar credits could be used for any salaries. Only the CGF offering memorandum disclosed salary as a potential use of soft dollars, and that disclosure nowhere indicated that such "salary" could be paid in an excessive amount pursuant to a divorce agreement to an individual performing no work for the firm.

Second, Mausner and J.S. Oliver did not disclose to their clients or fund investors that they would use client soft dollar credits to pay excessive rent to an entity owned by Mausner, or that Mausner would enrich himself by funneling the excess "rent" to his personal bank account. Additionally, such payments clearly were not in the best interest of J.S. Oliver's clients. While the Forms ADV, Part II and J.S. Partner Funds' offering memoranda disclosed that certain narrow "overhead" expenses could be paid with soft dollars, the disclosures did not mention rent. Rather, they identified "telephone charges, legal and accounting expenses, . . . office services, equipment and supplies." This is far from sufficient disclosure to address the use of soft dollars to pay rent, and it unquestionably is inadequate disclosure of the fact that Mausner was diverting hundreds of thousands of dollars in excess "rent" payments to himself. *See SEC v. Syron*, 2013 U.S. Dist. Lexis 48183, *50 (S.D.N.Y March 28, 2013) (citations omitted) (a party "ha[s] a duty to be both accurate and complete" with respect to disclosures of material issues so as to avoid rendering statements misleading"). Further, although CGF's offering memo allowed payment of

rent, the narrow disclosure again was far from sufficient to disclose what was being done with client soft dollar credits. The CGF offering memorandum did not disclose that J.S. Oliver would use soft dollars to pay inflated rent on a property that Mausner also used for personal purposes. *See, e.g., In the Matter of Lisa B. Hovan, CPA*, AP File No. 3-15193, 2013 SEC Lexis 298, *3-4 (Jan. 29, 2013) (settled administrative proceeding in which respondent was sanctioned for using soft dollars to pay, among other things, the adviser's rent).

Mausner also had no justification for increasing the amount of rent from $6,000 to $15,000 over a six-month period, and there was never any disclosure that Mausner could unilaterally raise the rent, pay the rent with client soft dollars, and then divert the excess amount to himself. When Mausner set the rent that J.S. Oliver paid for the office space at an amount far over the actual mortgage paid, instructed Instinet to pay JO Samantha the rent amount, and then transferred the amount in excess of the mortgage to Mausner's personal bank account at Mausner's direction, it constituted a misappropriation of clients' assets that was not disclosed. The CGF disclosure certainly did not inform clients that Mausner was enriching himself with the excess "rent" payments. Additionally, while the disclosure in the CGF offering memorandum allowed the use of soft dollar credits to pay rent, any rent legitimately payable by the firm should have been an amount representing the pro rata portion of the house dedicated and used for the advisory business and not the entire residence. Based on the disclosures, investors would not reasonably expect that payments using soft dollars for rent would not only fully cover but greatly exceed Mausner's obligations on his personal residence.

Third, Mausner and J.S. Oliver did not disclose to their clients or fund investors that they would use client soft dollar credits to pay fees on Mausner's personal timeshare, and such payments were not in the best interest of J.S. Oliver's clients. The disclosure in J.S. Oliver's Forms ADV, Part II and J.S. Partner Funds' offering memoranda provided that soft dollars may

be used to reimburse travel expenses related to conferences only, and the CGF offering memorandum allowed soft dollar payments for "travel, meals and lodging" only if it was connected to a "potential investment opportunity." There is no evidence that Mausner used his personal timeshare for such purposes and, even if he did, fees relating to his personal timeshare still should not be charged to clients without specific disclosure.

Finally, Mausner and J.S. Oliver did not disclose to their clients or fund investors that they would use client soft dollar credits to pay Drennan's salary and bonus, and such payments were not in the best interest of J.S. Oliver's clients. Drennan was not an outside research analyst, but rather a full-time J.S. Oliver employee who performed many duties in addition to research. Importantly, the soft dollar payments Drennan received would have been improper even if made to him as an employee. Although the CGF offering memorandum disclosed that J.S. Oliver could use soft dollars to pay employee salaries, the Forms ADV, Part II and the J.S. Partners Funds' offering memoranda did not contain such disclosures. *See Lisa B. Hovan, CPA*, 2013 SEC Lexis 298, * 3-4 (settled administrative proceeding in which respondent was sanctioned for using client soft dollars to pay employee salaries).

Mausner acted with scienter. Mausner knew that J.S. Oliver requested that the brokers pay these expenses using soft dollars and that many of the payments financially benefitted him. In submitting a purported excerpt to a contract to Instinet in support of the payment to his ex-wife, Mausner directed that the language be altered in significant ways: making it appear the agreement was between Ms. Kloes and J.S. Oliver, and deleting references to personal items, such as the nanny and housekeeper. Mausner also markedly increased the monthly rent amount at the time he began using client soft dollars to pay the rent and he told Drennan that the use of soft dollars to pay rent contributed to his decision to increase the monthly rent amount. Additionally, Mausner directed his employees to transfer the amounts in excess of the mortgage

payments to his personal bank account. Finally, by paying Drennan with soft dollars, Mausner was able to keep J.S. Oliver's operating expenses down, thus improving the firm's financial condition. Mausner's scienter regarding the soft dollar fraud is imputed to J.S. Oliver. *See Manor Nursing Ctrs., Inc.*, 458 F.2d at 1089 n.3, 1096-97 n. 16-18.

2. Mausner and J.S. Oliver Violated Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

a) Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder

To establish a violation of Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder, the Division must show the respondent: (1) made an untrue statement or omitted to state a material fact; (2) with scienter; (3) in connection with the purchase or sale of securities. *SEC v. Todd*, 642 F.3d 1207, 1215 (9th Cir. 2011). A statement or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). "For the purpose of Rule 10b-5, an investment adviser is a fiduciary and therefore has an affirmative duty of utmost good faith to avoid misleading clients. This duty includes disclosure of all material facts and all possible conflicts of interest." *Laird v. Integrated Resources, Inc.*, 897 F.2d 826, 833-34 (5th Cir. 1990) (citing *SEC v. Blavin*, 760 F.2d 706 (6th Cir. 1985) and *Zweig v. Hearst Corp.*, 594 F.2d 1261 (9th Cir. 1979)). The Commission has long held that if an investment adviser "chooses to assume a role in which she is motivated by conflicting interests" that she must make full disclosure. *In the Matter of Arleen W. Hughes*, Release No. 34-4048, 1948 WL 29537 (Feb. 18, 1948) (Commission opinion affirming the finding of willful violations of, among other provisions, Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder) (cited with approval in *In the Matter of Marc N. Geman*, Release No. 34-43963, 2001 WL 124847 (Feb. 14, 2001), *aff'd, Geman v. SEC*, 334 F.3d 1183 (10th Cir. 2003)).

Moreover, an investment adviser has a duty to update its clients if circumstances have changed such that previous disclosures, even if true when made, have become misleading. *See In re Beacon Assocs. Litig.*, 745 F. Supp. 2d 386, 414-15 (S.D.N.Y. 2010) (in considering a motion to dismiss a Section 10(b) claim, the court found that the duty to update applies to a statement made misleading by intervening events, even if the statement was true when made); *see also In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410 (3d Cir. 1997) (discussing the duty to update providing a basis for a duty to disclose in a Section 10(b) case where "statements that, although reasonable at the time made, become misleading when viewed in the context of subsequent events."); *United States v. Gordon*, 2013 U.S. App. Lexis 5251 *49 (10th Cir. Mar 15, 2013) ("[W]here a party without a duty elects to disclose material facts, he must speak fully and truthfully, and provide complete and non-misleading information") (quoting *SEC v. Curshen*, 372 Fed. Appx. 872, 880 (10th Cir. 2010) (internal quotation marks omitted)).

The evidence will show that Mausner and J.S. Oliver violated Section 10(b) and Rule 10b-5(b) thereunder because, acting with scienter, they failed to disclose to clients that they cherry-picked winning trades for favored accounts and allocated less profitable trades to the disfavored accounts. This is a blatant and material omission. Because the cherry-picking was not revealed, the disfavored accounts had no idea Mausner and J.S. Oliver were allocating unprofitable trades to those accounts, while allocating the profitable ones to the favored accounts that Mausner personally invested in.

Mausner and J.S. Oliver also violated Section 10(b) and Rule 10b-5(b) thereunder because they omitted to state material facts concerning soft dollars in connection with the purchase or sale of securities. J.S. Oliver traded in clients' securities, generating soft dollar credits. Such trading "satisfies the 'in connection with' requirement of Section 10(b)." *In re Sage Advisory Services LLC*, 2001 SEC Lexis 1482, *21 (citations omitted).

In particular, the disclosures in the J.S. Partner Funds' and CGF's offering memoranda and J.S. Oliver's Forms ADV, Part II contained material omissions concerning J.S. Oliver's use of soft dollar credits. First, as to the disclosures in the Forms ADV, Part II, Mausner and J.S. Oliver had a fiduciary duty to their individual clients to disclose their conflicts of interest. As noted above, the Forms ADV, Part II failed to disclose several ways in which J.S. Oliver and Mausner used soft dollars to enrich themselves. Even though J.S. Oliver filed an amended Form ADV, Part II in March 2009, it failed to amend its soft dollar disclosures from its prior filing in March 2007 to reflect accurately how J.S. Oliver was using client soft dollars. To the contrary, the firm narrowed the disclosure by disclosing soft dollar uses only as it related to the hedge funds and not separately managed client accounts.

Second, J.S. Oliver's use of soft dollars in 2009 was much broader than the disclosures in the hedge funds' offering memoranda. Once J.S. Oliver and Mausner started using soft dollars in ways inconsistent with those disclosures, those disclosures became materially misleading and Mausner and J.S. Oliver had a duty to update the information regarding their actual soft dollar practices. *See In re Beacon Assocs. Litig.*, 745 F. Supp. 2d at 410. Additionally, although the CGF offering memorandum disclosed the potential use of soft dollars for employee salaries and rent, it did not state that Mausner could use soft dollars to pay his ex-wife pursuant to their divorce agreement or pay Mausner's personal timeshare expenses. Nor did it disclose the full extent to which J.S. Oliver used client soft dollars to divert the amounts in excessive "rent" to Mausner. By listing some specific uses for soft dollars outside Section 28(e) but not others, these disclosures were misleading. J.S. Oliver should have limited itself to using soft dollars in a manner consistent with those disclosures, or updated its disclosures. It did neither.

These omissions were material. "To fulfill the materiality requirement there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by a

reasonable investor as having significantly altered the total mix of information made available." *Basic Inc.*, 485 U.S. at 232 (internal quotations omitted). The evidence will show that the manner in which Mausner and J.S. Oliver used soft dollars would have been important to a reasonable investor.

The evidence will show that Mausner is directly liable for these antifraud violations. In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the Supreme Court held that "the maker of a statement [for purposes of Rule 10b-5(b)] is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id.* at 2302. All of the statements made by J.S. Oliver are attributable to Mausner. Mausner owned and controlled J.S. Oliver, and signed the Forms ADV. Mausner is also the only person responsible for the statements in the offering memoranda - he controlled both J.S. Oliver (the investment adviser to the funds) and the general partner to the funds, and he reviewed and approved the offering memoranda before they were sent to clients and fund investors. Accordingly, under *Janus*, Mausner is a primary violator of Rule 10b-5(b).

b) Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) Thereunder

Rules 10b-5(a) and (c) make it unlawful "to employ any device, scheme, or artifice to defraud" and "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of any security. "Any person who directly or indirectly engages in a manipulative or deceptive act as part of a scheme to defraud can be a primary violator" of Section 10(b) and Rule 10b-5(a). *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006), vacated on other grounds by *Simpson v. Homestore.com, Inc.*, 519 F.3d 1041 (9th Cir. 2008). "To be liable for a scheme to defraud, a defendant must have 'committed a manipulative or deceptive act in

furtherance of the scheme.'" *SEC v. Fraser*, 2010 U.S. Dist. Lexis 7038, at *23 (D. Ariz. Jan. 28, 2010) (quoting *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997)). The defendant must have "'engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme.'" *SEC v. Brown*, 740 F. Supp. 2d 148, 172 (D.D.C. 2010) (quoting *Simpson*, 452 F.3d at 1048). Here, the evidence will show that J.S. Oliver and Mausner perpetrated a scheme to defraud and engaged in a course of business that operated as a fraud with respect to the cherry-picking and the misuse of soft dollars.

The cherry-picking of more profitable trades for the favored accounts at the expense of the disfavored accounts constituted a fraudulent scheme and a deceptive practice. Mausner and J.S. Oliver disproportionately allocated favorable trades to six clients to the severe detriment of three of its individual clients, causing them $10.9 million in harm. As set forth above, Mausner acted with scienter in operating the cherry-picking scheme. He knew or was reckless in not knowing that he allocated trades after the close of the market in a manner calculated to award the hedge fund accounts trades that were more favorable in either purchase or sale price than those he allocated to the disfavored accounts. Further, the cherry-picking scheme was "in connection with" the purchase or sale of securities because it was directly related to how purchased and sold securities were allocated among clients. *See SEC v. Zandford*, 535 U.S. 813, 819-20 (2002) (when securities transactions and breaches of fiduciary duty coincide, those breaches are "in connection with" securities sales); *see also In the Matter of Middlecove Capital, LLC, et al.*, Advisers Act Rel. No. 3534 (Jan. 16, 2013) (settled administrative proceeding for violating among other provisions Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by engaging in cherry-picking scheme which favored adviser's personal or business accounts at the expense of his clients); *In the Matter of James C. Dawson*, Advisers Act Rel. No. 3057 (Dec. 18, 2009) (ALJ initial decision) (same).

The evidence will also show that Mausner and J.S. Oliver conducted a fraudulent scheme in repeatedly misusing client soft dollars. Mausner engaged in numerous deceptive acts in support of that scheme, including alteration of contract language provided to Instinet in support of the payment to Ms. Kloes, grossly inflating the "rent" on his home to generate hundreds of thousands of dollars in excess funds that he diverted to himself, and mischaracterizing to Instinet the purpose of soft dollar payments (e.g., providing an invoice that requested reimbursement for travel for "evaluation of potential investment opportunities" when the payment was for the timeshare maintenance fees). As set forth above, Mausner acted with scienter in operating the soft-dollar scheme. Further, the soft-dollar scheme was "in connection with" the purchase or sale of securities because it related to soft-dollar credits generated from the purchase and sale of securities. *See SEC v. Zandford*, 535 U.S. at 819-20; *see also In the Matter of William F. Branston*, Advisers Act Rel. No. 2040 (June 26, 2002) (settled administrative proceeding for violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by, among other things, submitting invoices for services falsely claimed to be for the benefit of advisory clients and obtaining cash from soft dollar credits as a result).

3. Mausner and J.S. Oliver violated Section 17(a) of the Securities Act

Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of any securities by the use of interstate commerce (1) to employ any device, scheme, or artifice to defraud, (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. The Supreme Court has expansively interpreted the phrase "in the offer or sale." *See United States v. Naftalin*, 441 U.S. 768, 778 (1979) (Section 17(a) was "intended to

cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading"). Section 17(a)(1) requires scienter. *See Aaron v. SEC*, 446 U.S. 680 (1980). Sections 17(a)(2) and (3) do not. *Id.*

The evidence will show that Mausner's and J.S. Oliver's conduct violated Section 17(a)(2) of the Securities Act. In particular, Mausner and J.S. Oliver violated Section 17(a)(2) by selling securities to obtain soft dollar credits, but failing to disclose to their clients how J.S. Oliver actually used soft dollars. Mausner and J.S. Oliver "obtain[ed] money or property" in the form of soft dollar payments. Mausner and J.S. Oliver also violated Section 17(a)(2) by selling securities that they then misallocated among the favored and disfavored accounts. In doing so, they did not disclose to clients that they cherry-picked winning sales for favored accounts and allocated less profitable sales to the disfavored accounts. Mausner and J.S. Oliver "obtain[ed] money or property" as a result because Mausner and his related entities, as investors in CGF, received money from the favored allocations, and J.S. Oliver received performance fees from CGF that the firm would not have received but for the favored allocations.

Mausner and J.S. Oliver also violated Section 17(a)(1) in operating the cherry-picking and soft-dollar schemes discussed above. These violations were "in the offer or sale" of securities in that both the cherry-picking and soft dollar schemes included the sale of securities. *See Naftalin*, 441 U.S. at 778. Further, Mausner and J.S. Oliver acted at least recklessly (if not knowingly) in that they knew, or should have known, that when they made those sales that they would misallocate the trades as part of their scheme, and misuse the soft dollars. Mausner and J.S. Oliver also violated Sections 17(a)(1) and (3) by offering interests in CGF using the inflated performance numbers without disclosing that CGF's positive performance was attributable, in part, to their fraudulent allocation of favorable trades to CGF.

4. Mausner and J.S. Oliver violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder

Section 206(4) of the Advisers Act prohibits an investment adviser from, directly or indirectly, engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. Rule 206(4)-8(a)(1) prohibits an investment adviser to "pooled investment vehicles," such as hedge funds, from making an untrue statement of material fact or omitting to state a material fact necessary to make the statements made not misleading to investors or prospective investors in those pools. Rule 206(4)-8(a)(2) provides that it is a fraudulent practice for an investment adviser to a pooled investment vehicle to engage in "fraudulent, deceptive, or manipulative" conduct with respect to any investor or prospective investor in the pooled vehicle. *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles,* Advisers Act Rel. No. 2628, 2007 SEC Lexis 1736 (Aug. 3, 2007). Pooled investment vehicles include hedge funds. *Id.* at 13. Scienter is not required; the rule reaches conduct that is negligently deceptive. *Id.* at 23-24. Because Mausner and J.S. Oliver made investment decisions on behalf of the J.S. Partner Funds and CGF – all pooled investment vehicles – for a fee, each can be considered an investment adviser to these vehicles under Section 202(a)(11) of the Advisers Act.

Mausner and J.S. Oliver violated Rule 206(4)-8(a)(1) by providing prospective investors in CGF with performance data that was fraudulently inflated by virtue of the cherry-picking scheme. Mausner did not advise these prospective investors that CGF's positive performance was attributable to fraudulent allocation of favorable trades to CGF and unfavorable trades to the accounts of several individual clients. Mausner and J.S. Oliver also violated Rule 206(4)-8(a)(1) by, as discussed above, making material omissions in the offering memoranda disclosures concerning how J.S. Oliver used soft dollars.

Mausner and J.S. Oliver and also violated Rule 206(4)-8(a)(2) through their soft-dollar scheme. With respect to the CGF offering, as set forth above, the inflated performance statistics touted by Mausner to induce investments in CGF had been generated as a result of the cherry-picking scheme. With respect to soft dollars, Mausner's and J.S. Oliver's soft dollar scheme included the alteration of documents and mischaracterization of expenses in documents provided to Instinet in order to use soft dollars in manners not disclosed to fund investors.

5. Drennan willfully aided and abetted and caused J.S. Oliver's antifraud violations of the securities laws relating to soft dollar practices

To establish aiding and abetting liability, the Commission must show: (1) the existence of an independent primary wrong; (2) actual knowledge or reckless disregard by the alleged aider and abettor of the wrong and of his/her role in furthering it; and (3) the aider and abettor substantially assisted in the accomplishment of the primary violation. *See In the Matter of vFinance Investments, Inc., et al.*, Exchange Act Rel. No. 62448, 2010 SEC Lexis 2216, *41 (July 2, 2010) (Commission Opinion). In administrative proceedings, the Commission applies a "recklessness" standard for aiding and abetting liability. *Id.* at *46; *see also Voss v. SEC*, 222 F.3d 994, 1004-06 (D.C. Cir. 2000). The recklessness standard is satisfied where the respondent fails to use due diligence to investigate a circumstance with unusual factors or ignores red flags and suggestions of irregular conduct. *See Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) "A defendant provides substantial assistance only if [he] affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed." *SEC v. Espuelas*, 698 F. Supp. 2d 415, 433 (S.D.N.Y. 2010) (internal quotation marks and citations omitted); *see also SEC v. Apuzzo*, 689 F.3d 204, 213 (2d Cir. 2012) (holding that "[t]he SEC is not required to plead or prove that an aider and abettor proximately caused the primary securities fraud violation.").

For "causing" liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his act or omission would contribute to the violation. *In the Matter of Robert M. Fuller*, Exchange Act Rel. No. 48406, 2003 SEC Lexis 2041 (Aug. 25, 2003), *petition for review denied*, 95 F. App'x. 361 (D.C. Cir. 2004). A finding that a respondent willfully aided and abetted violations of the securities laws necessarily makes that respondent a "cause" of those violations. *See In re Clarke T. Blizzard, et al.*, Advisers Act Rel. No. 2253, 2004 SEC Lexis 1298, at *16 n.10 (June 23, 2004) (Commission Opinion).

The evidence will show that Drennan aided, abetted, and caused J.S. Oliver's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 17(a)(1) and (2) of the Securities Act, and Sections 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder. Drennan knowingly, and with extreme recklessness, provided substantial assistance in J.S. Oliver's fraud violations with respect to the misuse of soft dollars. Drennan knew the disclosure documents did not address all the items for which J.S. Oliver sought payment and he also provided substantial assistance with respect to the following soft dollar expenses:

- Payment to Ms. Kloes

Drennan prepared the altered contract excerpt knowing that it was false and that it was to be provided to Instinet in support of the reimbursement for J.S. Oliver's payment to Ms. Kloes. In addition, Drennan made misrepresentations to Instinet about Ms. Kloes despite encountering red flags indicating Ms. Kloes had no obligation to work for, and had not provided any work for, J.S. Oliver. Drennan also approved this payment in Instinet's soft dollar system on J.S. Oliver's behalf.

- Rent Payments

Drennan approved at least three inflated rent invoices in Instinet's soft dollar system after Mausner had told him that the ability to pay rent with soft dollars was a contributing factor in raising the rent amount. Drennan also knew that Mausner was directing employees to distribute money to Mausner from the account of the entity that received the rent payments.

- Powerhouse Capital Payments

Drennan knew that he was receiving payments for soft dollars as a purported research analyst under the safe harbor of Section 28(e), when he was in reality an employee of J.S. Oliver and thus not entitled to soft dollar payments based on the disclosures in the J.S. Partner Funds' offering memoranda and in the Forms ADV, Part II. Drennan drafted the Powerhouse Capital invoices and he approved at least three of the invoices for payment to Powerhouse Capital in Instinet's soft dollar system. The evidence will show that Drennan knew that salaries for research staff of an investment adviser were ineligible for payment with soft dollar credits under the safe harbor of Section 28(e).

B. J.S. Oliver Violated Section 204 of the Advisers Act and Rules 204-2(a)(3) and (7) Thereunder

Section 204 of the Advisers Act requires that investment advisers "make and keep" appropriate records in the course of conducting their business. The Commission does not need to prove that a respondent acted with scienter in order to establish a violation of Section 204. *See In the Matter of Lowe Management Corp.*, Advisers Act Rel. No. 759, 1981 SEC Lexis 1476 (May 11, 1981) (Commission Opinion) ("the failure to make a required report, even though inadvertent, constitutes a willful violation.").

Rule 204-2(a)(3) requires registered investment advisers to make and keep a "memorandum of each order given by the investment adviser for the purchase or sale of any

security." J.S. Oliver willfully violated Rule 204-1(a)(3) by failing to maintain trade memoranda with daily trade details from May 2008 to June 2009.

Rule 204-2(a)(7) requires that a registered investment adviser maintain originals of all written communications the investment adviser sends relating to "any recommendation made or proposed to be made and any advice given or proposed to be given." J.S. Oliver failed to maintain originals of Mausner's email messages that reflected the recipients of the emails that promoted CGF's performance and contained his "strong" recommendation that the recipients invest in CGF.

C. J.S. Oliver Violated Section 206(4) and Rule 206(4)-7 Thereunder

Advisers Act Rule 206(4)-7 makes it unlawful within the meaning of Section 206(4) for registered investment advisers to provide investment advice unless they "[a]dopt and implement written policies and procedures reasonably designed to prevent violation" of the Advisers Act and the rules thereunder by the investment adviser and its supervised persons.

J.S. Oliver had policies and procedures in place regarding trade allocation, but failed to implement them. J.S. Oliver's procedures relating to trade allocations required the creation and maintenance of trade memoranda with daily trade details, including allocations. From about June 2008 through mid-2011, however, the firm did not maintain such memoranda. Moreover, the policies required that allocations be done in a fair and equitable manner to all clients. As described above, J.S. Oliver's cherry-picking did not result in fair and equitable allocations to its clients.

D. Mausner Aided, Abetted, and Caused J.S. Oliver's Violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-2(a)(3), 204-2(a)(7), and 206(4)-7 Thereunder

The evidence will show that Mausner knew or was reckless in not knowing that J.S. Oliver (a) failed to keep trade memoranda and original email communications, (b) failed to

update its disclosures regarding soft dollar practices in its Forms ADV, Part II, (c) failed to follow its policies and procedures relating to trading allocations; and (d) advertised misleading performance information concerning CGF in emails that he sent. Thus, Mausner aided, abetted, and caused J.S. Oliver's violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-1(a)(2), 204-2(a)(7), and 206(4)-7 thereunder.

E. Mausner and J.S. Oliver Violated Section 207 of the Advisers Act and Rule 204-1(a)(2)

Section 207 of the Advisers Act makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission ... or willfully to omit to state in any such application or report any material fact which is required to be stated therein ...." Rule 204-1(a)(2) requires that an adviser must, in addition to the annual amendment, promptly update its Form ADV if information provided in Part II becomes materially inaccurate. Section 207 does not require a finding of scienter; it merely requires that a person act willfully, i.e., intent to do the act that constitutes the violation, regardless of whether he or she knew the act constituted a violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

Mausner and J.S. Oliver willfully violated Advisers Act Section 207. J.S. Oliver's Form ADV filed on March 3, 2009 made materially false statements about how it used soft dollars because the disclosures in Part II, Items 12 and 13: (1) stated that soft dollars would be used for specified expenses, when in fact J.S. Oliver used the client assets to pay for numerous unspecified expenses, and (2) did not disclose that soft dollars generated from individual client accounts would be used to pay J.S. Oliver's and Mausner's expenses. *See In the Matter of Parnassus Investments, et al.*, 1998 SEC Lexis 1877, *60-61 (Sept. 3, 1998) (Initial Decision) (holding that respondents violated Section 207 because they did not disclose soft dollar

arrangements as specifically required by Form ADV; these "arrangements are material because of the potential conflict of interest arising from an adviser's receipt of some benefit in exchange for directing brokerage on behalf of client accounts."); 1998 SEC Lexis 2181 (Oct. 8, 1998) (Final Decision). J.S. Oliver and Mausner also willfully failed to amend J.S. Oliver's Forms ADV, Part II, filed March 2007 and March 2009, to update information concerning its soft dollar practices in violation of Rule 204-1(a)(2).

IV. LEGAL ARGUMENT – RELIEF

Severe sanctions are appropriate against each of the respondents

A. Respondents' Violations Warrant Industry Bars Against Mausner and Drennan, Revocation of J. S. Oliver's Registration, and Cease-And-Desist Orders Against Each Respondent

Section 203(e) of the Advisers Act authorizes the Commission to sanction any investment adviser if it is in the public interest and the Commission finds that the adviser has willfully violated any provision of the federal securities laws. Section 203(f) of the Advisers Act authorizes the Commission to sanction any person associated with an investment adviser under the same circumstances. Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") authorizes the Commission to sanction any person under the same circumstances. Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act authorize the Commission to institute cease-and-desist proceedings against any person who has committed or caused a violation of these statutes, respectively. Based on the violations noted above, which evidence respondents' conscious and repeated disregard of their responsibilities under the federal securities laws, orders requiring the respondents to cease and desist from violating and aiding and abetting violations of the above-described provisions of the federal securities laws are warranted.

The Fifth Circuit's decision in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir.1979), is recognized as the leading case that establishes the standard courts should use when evaluating administrative actions involving disciplinary sanctions. *See, e.g., Gibson v. SEC*, 561 F.3d 548, 554-55 (6th Cir. 2009); *Seghers v SEC*, 548 F.3d 129, 134 (D.C. Cir. 2008); *Lowry v. SEC*, 340 F.3d 501, 504 (8th Cir. 2003); *In the Matter of Gregory D. Tindall*, Administrative Proceeding File No. 3-14894, 2012 SEC Lexis 3244 (Oct. 12, 2012). Under *Steadman*, a court must consider a number of factors when imposing disciplinary sanctions: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction, (3) the degree of scienter involved, (4) the sincerity of the respondent's assurances against future violations, (5) the respondent's recognition of the wrongful nature of his conduct, and (6) the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman*, 603 F.2d at 1140.

Respondents' actions in this case warrant the highest sanctions, and every one of the *Steadman* factors supports severe sanctions. Respondents' actions were egregious; they breached their fiduciary duties in multiple ways and placed their personal interests ahead of those of their clients and fund investors. Their actions enriched themselves while causing millions of dollars of harm to their clients, which included a charitable foundation and an elderly widow. Indeed, Mausner orchestrated two separate schemes whereby he could fleece his clients and personally benefit greatly from his fraud. Drennan actively facilitated Mausner's use of soft dollars, and he also personally benefited by $480,000 from the improper Powerhouse Capital payments. Respondents' violations extended over a lengthy period and evidenced a high level of scienter. Respondents have provided no assurance against future violations and, in fact, they continue to deny that they engaged in any misconduct. Given Mausner's and Drennan's

occupations, there is a strong likelihood that, if permitted, they will engage in such violations again in the future.

Accordingly, the Division requests that J.S. Oliver's registration as an investment adviser be revoked, and that Mausner and Drennan be permanently barred from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. *See, e.g., James C. Dawson*, 2010 SEC Lexis 2561, *8-9 (Commission held it was in the public interest to bar an investment adviser who had engaged in a cherry-picking scheme); *In the Matter of Raymond J. Lucia Companies, Inc., et al.*, 2013 SEC Lexis 3856 (Dec. 6, 2013) (Initial Decision) (barring individual who aided, abetted, and caused antifraud violations).

B. Disgorgement with Prejudgment Interest and Third-Tier Civil Penalties Should Be Ordered Against Each Respondent

Sections 203(j) and 203(k)(5) of the Advisers Act, 8A(e) of the Securities Act, 21B(e) and 21C(e) of the Exchange Act, and Section 9(e) of the Investment Company Act authorize the Commission to seek disgorgement in administrative or cease-and-desist proceedings, including reasonable interest. "Disgorgement is designed to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable." *SEC v. First Pacific Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1998), *cert. denied*, 525 U.S. 1121 (1999). Disgorgement need only be a "'reasonable approximation of profits causally connected to the violation.'" *Id.* at 1192 n.6 (quoting *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997)).

The Division seeks disgorgement, with prejudgment interest, from each of the respondents, in the amounts that they were unjustly enriched through their violations. J.S. Oliver and Mausner should be ordered, jointly and severally, to disgorge the $1.1 million in soft dollar

payments and the $212,000 in performance fees that CGF would not have earned but for Mausner's cherry-picking scheme. Drennan should be ordered to disgorge, jointly and severally with Mausner and J.S. Oliver, $480,000 of the soft dollar ill-gotten gains based on the payments Powerhouse Capital received from Instinet.

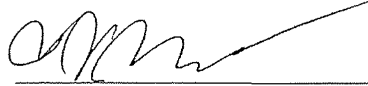
Finally, the Division seeks civil penalties against each of the respondents. In this case, imposition of third-tier civil penalties is appropriate because the conduct involved fraud and deliberate or reckless disregard of a regulatory requirement, and Respondents obtained substantial pecuniary gain from their conduct. *See* Section 203(i) of the Advisers Act. Pursuant to Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(b) of the Investment Company Act, the maximum third-tier penalty amount is $150,000 for a natural person and $725,000 for any other person for each act or omission in violation of the federal securities laws. *See In the Matter of Mark David Anderson*, 56 S.E.C. 840, 863 (Aug. 15, 2003) (Commission Opinion) (imposing a civil penalty for each of the respondent's ninety-six violations); Section 201.1004 and Table IV to Subpart E, Adjustment of civil monetary penalties – 2009, 17 C.F.R. Part 201.1004 and Table IV; *see also SEC v. DiBella*, 587 F.3d 553, 571-72 (2d Cir. 2009) (recognizing that aiders and abettors are subject to civil penalties under the Advisers Act). The Division therefore requests that third-tier penalties be ordered against each respondent for each of their violations.

V. CONCLUSION

Based on the foregoing, the Division respectfully requests that this Court make findings of fact with regard to the misconduct described above and that the requested sanctions be imposed on the respondents.

Dated: December 23, 2013

Respectfully submitted,



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