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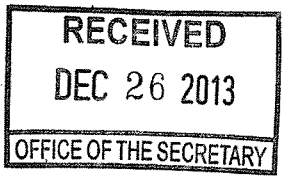

UNITED STATES OF AMERICA

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.

PRE-TRIAL SUBMISSION OF RESPONDENT DOUGLAS F. DRENNAN

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Pursuant to the Court's October 8, 2013 Order Following Prehearing Conference, Douglas Drennan respectfully submits this pre-trial brief.

I. INTRODUCTION

Douglas F. Drennan is an employee of J.S. Oliver Capital Management, L.P. ("JSO") who, during the period of the allegations in the Order Instituting Proceedings ("OIP"), operated an independent research firm called Powerhouse Capital, Inc. ("Powerhouse"), which provided services to JSO. The Division of Enforcement (the "Division") has brought a case against JSO and its owner, Ian Mausner, for "cherry picking". It has not charged any JSO employees or Mr. Drennan for involvement in that alleged scheme. Mr. Drennan knew nothing about allegedly cherry-picked trades and the Division does not contend otherwise.

The gravamen of the Division's claims against Mr. Drennan concern the period of time when he owned and operated his independent research firm, Powerhouse. As explained below, those claims lack any factual or legal basis.

The Division's Case Against Mr. Drennan Defies Logic.

The Division contends that Mr. Drennan received payments in soft dollars for providing independent third party research to J.S. Oliver Capital Management, L.P. ("JSO") through his firm Powerhouse when in fact he purportedly was functioning as an employee and therefore his activities did not fall within the "safe harbor" for soft dollar payments under Section 28(e) of the Exchange Act. The Division is essentially claiming that JSO chose to pay for Mr. Drennan's third-party research by treating him as an outside contractor rather than an employee because it wanted to utilize soft dollars to pay him.

There is just one small hole in this theory: JSO also paid the salary of its employees in 2009 and 2010 *using soft dollars* with the full knowledge of JSO's owner, Ian Mausner, Instinet, LLC. (JSO's soft dollar broker), and the JSO employees themselves. So that could not possibly have been the reason for the supposed conspiracy

to keep paying Powerhouse as a contractor rather than hiring Mr. Drennan as an employee, as the Division claims.

Why then would Mr. Drennan go through the trouble of forming a separate third party corporation to consult with JSO? The answer is simple: because he wanted to have an independent firm that could also work with other investment advisors and allow him to have a higher income. The Division's apparent theory that Mr. Drennan did this in order to permit JSO to pay him with soft dollars when JSO also paid its employees with soft dollars throughout 2009 and 2010 simply makes no sense.

Mr. Drennan Acted on the Advice of Counsel and Instinet.

Beyond making no sense, there is no evidence to support the Division's case against Mr. Drennan. The evidence at the hearing will show Mr. Drennan in fact provided independent third party research that was protected by the Section 28(e) safe harbor. Any activities performed by Mr. Drennan that were not eligible research under the safe harbor were covered by JSO's public disclosures.

The Division also asserts that Mr. Drennan aided and abetted certain other transactions by JSO that allegedly "misused" soft dollars, which are addressed in detail below (*see, infra,* Sections IV(B) and IV(C). The evidence will show, however, that these transactions were initiated by JSO's owner; Mr. Drennan had reason to believe and did believe that the transactions were appropriate; Mr. Drennan's activities with respect to these transactions were ministerial or clerical in nature; and Mr. Drennan did not benefit from the transactions. Thus there would be insufficient evidence to support aiding and abetting or causing violations against Mr. Drennan.

There is No Legal Basis to Seek Remedies Against Mr. Drennan.

To the extent the Division contends that JSO's use of soft dollars was inappropriate, it missed the mark in targeting Mr. Drennan. The evidence at the hearing will show that the soft dollar payments in question were fully disclosed to JSO's outside

counsel – who also drafted its soft dollar disclosures – and Instinet, the soft dollar broker that approved each payment.

All of the challenged payments were made by Instinet in 2009 and 2010 – a period during which Mr. Drennan was not even an employee of JSO, much less an officer or director that exercised any control over the entity. Mr. Drennan was an employee of JSO between 2004 and 2008 and then after 2011, but the Division does not (because it cannot) allege a *single* securities law violation by JSO during this period.

II. STATEMENT OF FACTS

A. Douglas Drennan

Mr. Drennan is 42 years old and lives with his wife, Jennifer Drennan, and their two children Andrew and Katherine, in San Diego, California. Mr. Drennan holds a Bachelor of Science in Finance from the University of Illinois. Mr. Drennan is the main income-earner for his family, which has been forced to sell its home in light of the legal costs of defending this case.

Mr. Drennan started his professional career at Merrill Lynch. Prior to 2004, he had worked at TD Securities and YCMNET Advisors as a research analyst and manager. Mr. Drennan has worked for 20 years in the financial industry as a research analyst specializing in technology and has never been the subject of any disciplinary proceeding by a self-regulatory organization, the Commission or any other governmental entity.

Mr. Drennan is not an attorney and has not had any legal training concerning soft dollars. Nor is Mr. Drennan a registered representative.

B. Mr. Drennan's Employment with JSO (2004-2008)

In January 2004, Mr. Drennan commenced work as a research analyst at J.S. Oliver Capital Management L.P. ("JSO"), a small registered investment adviser in San Diego that was owned by Ian Mausner, a business acquaintance. JSO is a Delaware limited partnership that is registered as an investment adviser with the Commission. JSO

was located at 4370 La Jolla Village Drive, Suite 660 in San Diego, California 92122. Its new mailing address is 2711 N. Sepulveda Blvd. #319 , Manhattan Beach CA 90266

During the relevant time period, JSO managed several investment funds and separate accounts, primarily for wealthy clients, totaling approximately $100 million in assets. The Chief Executive Officer and Senior Portfolio Manager of JSO is Ian Mausner, who had worked at Morgan Stanley, Kidder Peabody and Montgomery Securities (now Banc of America Securities) before co-founding JSO in early 2004. Mr. Mausner is a co-owner of J.S. Oliver Holdings, LLC, which is the general partner of JSO. Mr. Drennan has had no ownership interest in JSO.

Upon joining JSO, Mr. Drennan's title was Senior Portfolio Manager. His duties included researching stocks, entering and allocating trades, creating content for customer presentations, helping set up JSO's technology infrastructure, answering phones, addressing client inquiries, managing JSO's commission allocations, maintaining all sell-side broker relationships, travelling to sell-side sponsored conferences to meet with companies and analysts, travelling to and researching corporate management teams on location, talking daily with analysts and sales people regarding trade ideas, monitoring client portfolios, and maintain asset allocation weightings and cash levels.

C. The Law Firm Howard Rice Creates "Broad" Soft Dollar Disclosures for JSO

From its inception through 2008, JSO's outside counsel, Howard Rice Nemerovski Canady Falk & Rabkin, P.C. ("Howard Rice"), a highly respected corporate law firm[1], drafted the disclosure documents for JSO's investment funds. JSO has waived the attorney-client privilege with respect to Howard Rice's advice regarding soft dollars, so the Court will have the benefit of that evidence. That evidence will show Howard Rice drafted disclosures that its attorneys describe as "broad" and "aggressive" in connection with its potential use of soft dollars to give JSO substantial discretion in how

[1] Howard Rice merged with Arnold & Porter LLP on January 1, 2012.

to utilize such funds.

For example, JSO's Form ADV dated March 30, 2007 discloses, in relevant part, that:

> The Firm may also use Clients' soft dollars to acquire services and products that provide benefits to the Firm or its affiliates and that **may not qualify as research** or brokerage and/or to pay expenses otherwise payable by the Firm. These may include (but are not limited to): expenses of and travel to professional and industry conferences and hardware and software used in the Firm's or its affiliates' administrative activities. They may even include such "overhead" expenses as telephone charges, legal and accounting expenses of the Firm or its affiliates and office services, equipment and supplies. The use of soft dollars to pay costs of these types may not be directly proportionate to the benefits to the Client from which the soft dollars were generated. Using soft dollars for these purposes would not be protected by Section 28(e) and the Firm will have a conflict of interest if it does so.

Exhibit A at JSO 000384-85. JSO's Form ADV dated March 25, 2009 contains virtually verbatim disclosures. *See* Exhibit B at JSO 000368. The disclosures are discussed in detail in Sections IV(A)(1) and IV(C)(2), *infra*.

D. Mr. Drennan's Employment with aAd Capital (2008)

In May, 2008, Mr. Drennan decided to leave JSO because its funds had negative returns, reducing or eliminating the potential for incentive bonuses. Around that time, Mr. Drennan became aware of a technology analyst position at aAd Capital, which was a well-performing hedge fund. aAd Capital offered Mr. Drennan the position of technology analyst with ownership in the firm after an initial trial period. Mr. Drennan viewed the aAd capital position as an opportunity to increase his income.

Mr. Drennan joined aAd Capital in June 2008. Within a month of joining, however, aAd Capital's performance was significantly affected by the economic downturn. The turmoil in the markets caused aAd Capital's largest client to begin withdrawing funds. When it became apparent that the client was going to remove all assets, aAd Capital laid off its analysts. aAd Capital informed Mr. Drennan in August 2008 that he would be laid off on December 31, 2008.

Mr. Drennan began discussions with Ian Mausner in December 2008 concerning providing research services to JSO. Mr. Mausner discussed several compensation arrangements including returning as a salaried employee, being an outside consultant, or starting a new broker dealer joint venture. Mr. Drennan ultimately decided to provide JSO third-party research that would be paid with soft dollars.

E. Mr. Drennan establishes Powerhouse Capital, Inc.

After consulting with his accountant, Gregory Block, on how to track expenses for tax purposes and set up an S Corporation, Mr. Drennan established Powerhouse as an independent entity to provide research services. Through Mr. Block, Mr. Drennan filed the required form with the State of California to establish Powerhouse and followed proper incorporation formalities. He also filed separate tax returns for Powerhouse and himself.

Mr. Drennan's intent in setting up Powerhouse was to provide research services to as many customers as possible. The Division alleges that Powerhouse was not a genuine research business and that Mr. Drennan was simply an employee of Ian Mausner at JSO. The Division argues that the corporate formalities of Powerhouse were a ruse and that Mr. Drennan viewed himself as an employee of JSO. The Division will never meet its burden of proof in establishing such facts, because they are untrue.

Mr. Drennan paid the required fees and professional services to set up Powerhouse as a bona fide research firm. Beyond that, Mr. Drennan's own belief that he was operating a research organization is reflected in his contemporaneous emails and communications to colleagues and friends. The Division will not credibly dispute that Mr. Drennan made efforts to get additional clients for Powerhouse. The fact that Mr. Drennan failed to obtain more clients in 2009 shows only the extent of competition in the financial sector, not that Powerhouse was not trying to win other accounts.

The evidence will also show that – contrary to the Division's allegations, *see* OIP at ¶30 – Mr. Drennan's roles at Powerhouse were *fundamentally different* than the roles

and responsibilities he held as a JSO employee between 2004 and 2008. He no longer had any sales relationships. He did not set commissions. He did not attend conferences for JSO, speak to corporate management as a JSO representative, or receive invitations to certain events to which hedge funds were invited. The list goes on.[2]

Mr. Drennan had discussions with Instinet, the broker-dealer principally used by JSO to execute securities transactions, to ensure that the proper procedures for soft dollar payments were followed. Mr. Drennan had similar discussions with JSO's outside counsel, Howard Rice. In short, he did everything reasonably possible to assure compliance with soft dollar regulations, relying on the experts in that field.

F. JSO Hires Mr. Drennan as Chief Compliance Officer

In June of 2011, Melanie Kartes, JSO's then controller, left JSO. At the time, she oversaw the accounting at JSO. Around the same timeframe, the SEC was completing its normal audit of JSO. In an effort to create a more robust compliance environment, JSO decided to separate the roles of CEO and Chief Compliance Officer and add an independent outside compliance consultant. Mr. Mausner decided to hire Mr. Drennan as an employee with the title of Chief Compliance Officer. Mr. Drennan's duties as an employee of JSO differed substantially from his role as a consultant through Powerhouse. His new role as CCO required significant time and was not research related.

Mr. Drennan also became much more active in JSO's day-to-day operations and performed a number of tasks including: directing client wires, answering the phones and directly answering client questions, reviewing all technology and becoming the point person dealing with Roman Schwab, the technology consultant. Mr. Drennan also took over all trading, trade blotters and allocations. The Division does not allege any securities violations at JSO during the period that Mr. Drennan operated as its CCO.

[2] The Division may cite the fact that Mr. Drennan occasionally used an old JSO email account when he worked through Powerhouse. Those emails are backed up using Global Relay, a system that preserves emails for compliance reasons. Mr. Drennan's occasional use of the account simply assured that certain communications pertaining to JSO were kept confidential and protected. But Mr. Drennan was careful to remove the old signature block on that email account, which previously identified him as a JSO employee, since he no longer was one.

III. LEGAL STANDARDS

A. Soft Dollars

In 1975, the Commission and Congress terminated fixed commission rates. Institutional money managers expressed concern that they would be held liable for breaching their fiduciary duties to their clients if they utilized brokerage services that did not provide the lowest available commission rates, which could increase the difficulty of obtaining useful research. Broker-dealers expressed concern that they would no longer be compensated for their work product if money managers were compelled to use broker-dealers that provided the lowest possible rates for executing transactions.

Responding to these concerns, Congress included a "safe harbor" in Section 28(e) of the Exchange Act. The safe harbor "provides generally that a money manager does not breach his fiduciary duties under state or federal law solely on the basis that the money manager has paid brokerage commissions to a broker-dealer for effecting securities transactions in excess of the amount that another broker-dealer would have charged, if the money manager determines in good faith that the amount of the commissions paid is reasonable in relation to the value of the brokerage and research services" that are paid by client commissions.[3] *"Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934,"* 17 C.F.R. § 241, Securities Exchange Act Rel. No. 34-54165 (July 18, 2006) (hereafter, the "2006 Guidance"), at pp. 9-10. Thus "soft dollars" refers to the use of commissions charged by broker-dealers to pay for research or other services that fall within the Section 28(e) safe harbor.

While research often will be provided to the money manager by the broker-dealer executing brokerage transactions, soft dollars may also be used to pay for third-party research. 2006 Guidance at pp. 49-50. Indeed, "[t]hird-party research arrangements can

[3] *See* Section 28(e)(1).

benefit advised accounts by providing greater breadth and depth of research." *Id.* However, the broker-dealer (here, Instinet) whose commissions are being used to pay for the third-party research must ensure that the research falls within the safe harbor. *Id.* at 59.

B. Aiding and Abetting

1. Knowledge requirement

The standard formulation for aiding and abetting and causing liability is 1) an independent securities law violation committed by a third party; 2) the person who aided and abetted and caused the violation knew that his or her role was part of an overall activity that was improper; and 3) the aider and abettor and causer knowingly and substantially assisted the conduct that constituted the violation. *In the Matter of Lisa B. Premo,* Admin. Proc. File No. 3-14697, Initial Decisions Rel. No. 476, 2012 SEC LEXIS 4036, at *62-63 (Dec. 26, 2012). The critical issue is the knowledge element.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which was signed into law on July 21, 2010, amended Section 20(e) of the Exchange Act and Section 209(f) of the Advisers Act by providing that aiding and abetting liability may be supported by reckless rather than only knowing substantial assistance. Dodd-Frank also created aiding and abetting liability under the Securities Act. These provisions cannot be applied retroactively. *See Securities and Exchange Commission v. Daifotis,* No. C 11-00137 WHA, 2011 LEXIS 60226, at *31-38 (N.D. Cal. June 6, 2011)(aiding and abetting provisions of the Investment Company Act of 1940 created by Dodd-Frank could not be applied retroactively); *Jones v. Southpeak Interactive Corp.,* No. 3:12cv443, 2013 U.S. Dist. LEXIS 37999, at *19-26 (E.D. Va. Mar. 19, 2013) (Dodd-Frank does not have retroactive application). Thus for any allegations concerning conduct prior to July 21, 2010, which comprise the bulk of the allegations in the OIP, the Division of Enforcement is *required to prove actual*

knowledge, not simply recklessness, for aiding and abetting liability; and there could not be aiding and abetting liability under the Securities Act.

There must be a multitude of "red flags" and suspicious events to support a conclusion that the aider and abettor, or causer, knew [or recklessly disregarded] that he was contributing to an improper scheme. *In the Matter of Stephen J. Horning,* Admin. Proc. File No. 3-12156, Initial Decision Rel. No. 318, 2006 SEC LEXIS 2082, at *51-52 (Sept. 19, 2006) (citing *Howard v. SEC,* 376 F.3d 1136, 1142-43 (D.C. Cir. 2004)), *aff'd,* SEA Rel. No. 56886, 2007 SEC LEXIS 2796 (Dec. 3, 2007); *In the Matter of Amaroq Asset Mgt., LLC,* Admin. Proc. File No. 3-12822, Initial Decisions Rel. No. 351, 2008 SEC LEXIS 1612, at *33-34 (July 14, 2008).[4]

Even providing substantial assistance to the primary violation does not result in liability unless there was knowledge of the improper scheme. *In the Matter of Paul A. Flynn,* Admin. Proc. File No. 3-11390, Initial Decision Rel. No. 316, 2006 SEC LEXIS 1766, at *77-90 (Aug. 2, 2006)(respondent involved in activities that facilitated market timing but had no knowledge that activities were fraudulent); *In the Matter of Russo Securities Inc.,* Admin. Proc. File No. 3-8573, Securities Exchange Act. Rel. No. 39181, 1997 SEC LEXIS 2075, at *19-28 (Oct. 1, 1997) (respondents provided opinion to reset interest on bonds but insufficient evidence that respondents knew principal was trying to manipulate bond prices). As the *Horning* decision stated, "there must be proof that the person was aware or had knowledge of wrongdoing . . . In the absence of knowledge . . . an aider and abettor must have a state of mind close to conscious intent." 2006 SEC LEXIS 1766, at *52 (citing *Howard,* 376 F.3d at 1142) (emphasis added). Thus aiding and abetting liability cannot be predicated on gross or heightened negligence. Further, the alleged aider and abettor must have acted with scienter regardless of the level of proof required to establish the primary violation. *In the Matter of Harrison Securities, Inc.,*

[4] Several Commission decisions hold that recklessness would suffice if the respondent were a fiduciary of the clients of a money manager or broker-dealer. But Mr. Drennan was not an officer or employee of JSO during the relevant time period and therefore did not have a fiduciary duty to JSO's clients.

Admin. Proc. File No. 3-11084, Initial Decision Rel. No. 256, 2004 SEC LEXIS 2145, at *128 (Sept. 21, 2004) (collecting cases).[5]

2. Substantial Assistance

Generally, aiding and abetting cases concern individuals who were officers or senior employees of a company, a fund or a broker-dealer, and who engaged in conduct that significantly facilitated the illegal scheme, usually to their own benefit. Thus aiding and abetting or causing allegations were brought against a managing director of an investment adviser who prepared fake invoices to misappropriate client funds, *In the Matter of Brendan E. Murray,* Admin. Proc. File No. 3-12436, 2008 SEC LEXIS 2924, at *15-25 (Nov. 21, 2004); a corporate controller who knowingly recorded reserves that he knew were excessive, *In the Matter of Robert W. Armstrong,* Admin. Proc. File No. 3-9793, Initial Decisions Rel. No. 248, 2004 SEC LEXIS 789 (April 6, 2004); the director of a clearing broker who ordered a sham money market transaction to be entered on the firm's books, *Securities and Exchange Commission v. Goble,* 682 F.3d 934, 947 (11th Cir. 2012); a successful, sophisticated investment manager who knowingly concealed from a firm's valuation committee that there was a missed bond payment that affected fund valuation, *In the Matter of Lisa B. Premo,* 2012 SEC LEXIS at *44-71; and the chief executive officer and sole shareholder of a broker-dealer who created false accounting records and consciously violated net capital requirements, *In the Matter of Harrison Securities, Inc.,* 2004 SEC LEXIS, at *126-31.

By contrast, aiding and abetting liability is not found where the respondent had did not control the entity that committed the primary violation. *See In the Matter of Douglas W. Powell,* Admin. Proc. File No. 3-11086, Initial Decisions Rel. No. 255, 2004

[5] Causing liability is often deemed to have a negligence standard. But scienter is still required to be held liable for causing a primary violation that required scienter. *In the Matter of John A. Carley,* Admin. Proc. File No. 3-11626, Initial Decision Rel. No. 292, 2005 SEC LEXIS 1745, at *149-50 (July 18, 2005), *aff'd,* SEA Rel. No. 57246. 2008 SEC LEXIS 222 (Jan. 31, 2008), *modified,* SEA Rel. No. 61966, 2010 SEC LEXIS 1358 (April 23, 2010).

SEC LEXIS 1796, at *63-64 (Aug. 17, 2004) (rejecting aiding and abetting allegations against respondents who were not involved in day-to-day management of broker-dealer).

In related decisions, two individuals were found to have aided and abetted an investment adviser that directed a broker-dealer to provide client commissions to another broker-dealer that had referred a pension fund to be a client of the investment adviser. One respondent was found to have aiding and abetting liability where he negotiated the arrangement to direct client commissions to the second firm, which he knew provided no brokerage services; was told not to mention the second firm to the fund's trustees; and was aware of trips to the Cayman Islands for offshore banking. The other respondent was found to have aiding and abetting liability where he was an officer of the investment adviser having a fiduciary duty to the firm's clients and knew that directing commissions to the second firm violated the firm's internal policy. *In the Matter of Clarke T. Blizzard,* Admin. Proc. File No. 3-10007, Initial Decisions Rel. No. 229, 2003 SEC LEXIS 1419 (June 13, 2003), *rev'd, In the Matter of Clarke T. Blizzard,* Admin. Proc. File No. 3-10007, 2004 LEXIS 1298 (June 23, 2004); *In the Matter of Chris Woessner,* Admin. Proc. File No. 3-10607, Initial Decisions Rel. No. 225, 2003 SEC LEXIS 646 (March 19, 2003).

In another soft dollar matter, the chief portfolio manager of an investment adviser was held to have aiding and abetting liability where he affirmatively misrepresented the existence of soft dollar arrangements in soliciting investors and misled the Board of Directors concerning soft dollar arrangements. *In the Matter of Fundamental Portfolio Advisors, Inc.,* Admin. Proc. File No. 3-3-9461, 2003 SEC LEXIS 1654, at *55-56 (July 15, 2003).

As discussed below, the evidence does not support a finding by a preponderance of the evidence that Mr. Drennan knowingly engaged in conduct that he knew contributed to an improper scheme. Instead, the evidence shows that Mr. Drennan:

- was not responsible for managing JSO
- did not record entries in JSO's books and records

- did not solicit clients or prepare disclosures
- knew that the disclosures in question were drafted by attorneys who understood his role at Powerhouse
- was aware that Instinet and its internal soft dollar diligence team were aware of Powerhouse and its arrangement with JSO, vetted that arrangement, and concluded that it complied with applicable laws

The evidence, therefore, will prove that Mr. Drennan lacked knowledge of any violation and did not substantially assist in aiding and abetting or causing liability.

IV. ARGUMENT

A. Mr. Drennan Did Not Violate Any Securities Laws in Connection with Instinet's Payments to Powerhouse

The Division of Enforcement alleges Mr. Drennan should be liable for the benefit that JSO realized in utilizing soft dollars to compensate Mr. Drennan's research firm, Powerhouse Capital. Specifically, the Division alleges JSO "misused" soft dollars to make payments of $480,000 to Powerhouse Capital between 2009 and 2011 for research services. The Division claims Powerhouse Capital was not a legitimate research firm because Mr. Drennan worked from JSO's offices and that, when Mr. Drennan created Powerhouse, "he returned to JS Oliver and essentially resumed his prior duties at the firm." OIP ¶ 30. The division further alleges that "JS Oliver misrepresented to two soft dollar brokers that Powerhouse Capital was an outside research firm that provided research analysis to JS Oliver." *Id.* ¶ 29. The Division's allegations are factually and legally unsupported.

1. JSO's Payments to Powerhouse Were Consistent With Its Soft Dollar Disclosures

The Division's claims regarding Powerhouse are precluded as a matter of law because JSO publicly disclosed that soft dollar payments could be used for non-research activities. The Division does not deny that Mr. Drennan performed research for JSO through Powerhouse, but rather claims that Mr. Drennan also performed non-research services that are not reimbursable with soft dollars – *e.g.*, in his role as a "team leader" for certain activities. These claims never get off the ground because JSO's numerous

disclosures – drafted by experienced counsel at Howard Rice – clearly anticipate the use of soft dollars to pay for both research *and non-research* services.

a. JSO'S Form ADV Disclosures

JSO's Form ADV, dated March 30, 2007, contained fulsome disclosures regarding the potential use of soft dollars to pay for research and non-research services. That document discloses, in relevant part, that:

> The Firm may also use Clients' soft dollars to acquire **services** and products that provide benefits to the Firm or its affiliates and that **may not qualify as research** or brokerage and/or to pay expenses otherwise payable by the Firm. These may include (but are not limited to): expenses of and travel to professional and industry conferences and hardware and software used in the Firm's or its affiliates' administrative activities. They may even include such "overhead" expenses as telephone charges, legal and accounting expenses of the Firm or its affiliates and office services, equipment and supplies. The use of soft dollars to pay costs of these types may not be directly proportionate to the benefits to the Client from which the soft dollars were generated. Using soft dollars for these purposes would not be protected by Section 28(e) and the Firm will have a conflict of interest if it does so.

See Exhibit A, at JSO 000384-85 (emphasis added). JSO's Form ADV dated March 25, 2009 (also drafted by Howard Rice) contained virtually identical disclosures. *See* Exhibit B at JSO 000368.

The evidence at trial will show that Instinet (the soft dollar broker) had access to and reviewed JSO's Form ADVs, but never informed Mr. Drennan – who is neither an attorney nor an expert on soft dollar regulations – that the payment of Powerhouse using soft dollars was in any way problematic.

b. The Offering Memoranda for JSO's Investment Funds

In addition to JSO's Form ADVs, the offering memoranda for JSO's four funds also disclosed the use of soft dollars for non-research services. The offering memorandum for J.S. Oliver Investment Partners, I, L.P. ("Fund I"), dated June 2006, disclosed, in relevant part:

> The Fund will bear all of its ongoing operating costs. These include, among other things, brokerage commissions... expenses incurred by the Investment Manager for investment research and due diligence... other professional fees...and all other reasonable expenses related to the management and operation of the Fund or the purchase, sale or transmittal of Fund assets, all as the General Partner determines in its sole discretion. The Investment Manager may cause some or all of those costs to be paid using "soft dollars".

See Exhibit C at JSO 001354 (emphasis added). The offering memorandum for J.S. Oliver Investment Partners, II, L.P. ("Fund II") contains identical language. *See* Exhibit D at JSO 001141.

The offering memoranda for J.S. Oliver Offshore Investments, Ltd. ("Offshore") and J.S. Oliver Concentrated Growth Fund, L.P. ("CGF") also contain similar, if not stronger, language. The August 2008 memorandum for CGF specifically disclosed that the Investment Manager (i.e. JSO) may pay a variety of non-research overhead and office expenses with soft dollars, including "rent, salaries, benefits and other compensation of employees or of consultants to the Investment Manager." *See* Exhibit E at INST-4th 025921 (emphasis added).

The evidence will show that Howard Rice drafted these disclosures for JSO to be as broad as possible in order to protect JSO. Significantly, the disclosures above not only allow for research services, but they also allow for non-research services, unspecified professional and consulting services, and even *employee salaries*. Accordingly, JSO's payments to Powerhouse were covered by the disclosures even if we assume, *arguendo*, that Mr. Drennan's work through Powerhouse should be construed as non-research consulting work or the work of an employee.

It is well established that such disclosures cure any potential violation from the use of soft dollars to pay for non-research activities. *See In the Matter of Value Line, Inc.,* Admin. Proc. File No. 3-13675, 2009 SEC LEXIS 3923, at *13-14 (Nov. 4, 2009); *In the Matter of Putnam Inv. Mgt., LLC,* Admin. Proc. 3-11868, 2005 SEC LEXIS 675, at *18-20 (March 23, 2005); *In the Matter of Founders Asset Mgt. LLC,* Admin. Proc. File No. 3-10232, 2000 SEC LEXIS 762, at *5-7 (June 15, 2000); *In the Matter of*

Renaissance Capital Advisors, Inc., Admin. Proc. File No. 3-9514, 1997 SEC LEXIS 2643, at *7-9 (Dec. 22, 1997); *see also Securities and Exchange Commission v. St. Anselm Exploration Co.,* Civil Case No. 11-cv-00668-REB-MJW, 2013 U.S. Dist. LEXIS 45547, at *35-36 (D. Colo. March 29, 2013) (subscription agreement stating that investor funds could be used for any purpose was not misleading for failing to specifically identify debt service as one possible use).

2. Mr. Drennan Believed He Was Acting Appropriately In Compliance with the Legal Advice of Howard Rice

The disclosures above are sufficient to end the Division's case against Mr. Drennan. But even if JSO's disclosures, drafted by Howard Rice, are found to be imperfect, that does not result in liability by Mr. Drennan, who did not control JSO at the time in question.

The key issue with respect to Mr. Drennan is not whether knowledgeable lawyers, with benefit of hindsight, can debate the adequacy of JSO's disclosures. The issue is whether Mr. Drennan, a non-lawyer with no formal training in soft dollar regulation, had a reasonable good faith belief that JSO's disclosures satisfied legal requirements. *See In the Matter of Kingsley, Jennison, McNulty & Morse, Inc.,* Admin. Proc. File No. 3-7446, Initial Decision Rel. No. 24, 1991 SEC LEXIS 2587, at *69-70 (Nov. 14, 1991) (sanctions not imposed where respondent was uncertain concerning law on soft dollars and believed that arrangements at issue and disclosures were lawful); *aff'd,* IA Rel. No. 1396, 1993 SEC LEXIS 3551 (Dec. 23, 1993).

As mentioned above, *see supra,* Section II(B), the standard formulation for aiding and abetting and causing liability requires proof that the accused *knew* that his or her role was part of an overall activity that was improper and *knowingly* and substantially assisted the conduct that constituted the violation. *In the Matter of Lisa B. Premo,* Admin. Proc. File No. 3-14697, Initial Decisions Rel. No. 476, 2012 SEC LEXIS 4036, at *62-63 (Dec. 26, 2012). The evidence will not support a finding that Mr. Drennan was aware of any violations. Instead, it will prove that Mr. Drennan acted in conformity with the advise of

JSO's counsel and soft-dollar broker and acted in good faith while he performed services for JSO through Powerhouse.

a. Mr. Drennan's Professional Services to JSO (Through Powerhouse) Were Almost Entirely Research Related

Mr. Drennan established Powerhouse Capital ("Powerhouse") as an independent entity to provide research services. Mr. Drennan filed the required form with the State of California to establish Powerhouse. He also filed separate tax returns for Powerhouse and himself. Mr. Drennan attempted to solicit other clients for his research, but JSO turned out to be the only purchaser. Thus the record shows that Mr. Drennan established Powerhouse as an independent entity – separate from JSO – to provide third-party research.

The evidence will overwhelmingly show that Mr. Drennan, through Powerhouse, provided legitimate third-party services to JSO that came within the safe harbor of Section 28(e) or other professional services that (while outside of the safe harbor) were adequately covered by JSO's disclosures. The evidence at trial will show that Mr. Drennan provided eligible research covered by the safe harbor and followed a predictable daily routine that focused on research:

- Mr. Drennan typically arrived at work at 5:30 a.m. He would review overnight markets in Asia and Europe, as well as other economic news that could affect the financial markets. Mr. Drennan then reviewed news on specific companies and industry sectors that could affect stock prices. He specifically focused on news concerning potential takeovers or other major corporate transactions; earnings releases; preannouncements; debt or equity offerings; and analyst upgrades or downgrades. Mr. Drennan then conveyed this information – most often orally but also by email or by instant message when Mr. Mausner was not available in person or by phone.

- After the U.S. markets opened at 6:30 a.m. Pacific Time, Mr. Drennan tracked the movement of specific stock prices to ascertain any unusual activity. If there were significant stock price movements, Mr. Drennan conducted research into the reason for the move and whether the movement appeared justified by economic fundamentals. He reviewed company filings, including its financial statements; key industry factors; news concerning competitors; and major macroeconomic factors. Mr. Drennan also participated in earnings

conference calls and reviewed conference call notes. Mr. Drennan would then provide JSO with a summary of the information.

- Mr. Drennan also specialized in following a few stocks, such as VeriFone Systems, Inc. ("VeriFone"), in which JSO held a substantial position. Mr. Drennan conducted research into the reason for a steep stock price decline in response to an apparent leveling off of revenue growth. JSO increased its position in VeriFone based on Mr. Drennan's analysis that the stock was undervalued.

All of this activity constitutes eligible research under the Section 28(e) safe harbor, based on the 2006 Guidance.

The Division considers Mr. Drennan's research suspect because it was largely provided to JSO in oral, rather than in written, form.[6] But the 2006 Guidance makes plain that oral research is eligible; the research need not be written or recorded. Information concerning market data, including stock quotes, last sales prices, trading volumes and company financial data, constitutes eligible research. Such research also includes information on specific companies, such as the information that Mr. Drennan provided on VeriFone. Eligible research also includes information on stock market trends; economic factors; and earnings calls. All that is required is that the research reflect "substantive content – that is, the expression of reasoning or knowledge." 2006 Guidance at pp. 27-28, 34-36. The evidence will show that Mr. Drennan satisfied this basic requirement.

In any event, as mentioned above, to the extent Mr. Drennan performed non-research work for JSO, that does not support any legal claim against him because the disclosures discussed above specifically anticipated *non*-research professional services. *See, supra,* Section IV(A)(1). Moreover, such non-research activities were minimal after the early 2009 period. Again, the issue is not whether experienced attorneys with the knowledge of hindsight can find fault with the detailed disclosures. The issue is whether Mr. Drennan, a non-lawyer with no formal training in soft dollars regulation, had a

[6] That Mr. Drennan would verbally report his research findings and recommendations to Mr. Mausner at JSO is unremarkable given that when they were both present in the office, they sat next to each other and when they were not both present in the office, they often spoke on the phone.

reasonable good faith belief that JSO's disclosures satisfied legal requirements. The Division has no evidence to suggest Mr. Drennan did not act in good faith.

b. Howard Rice Advised JSO That Powerhouse Could Be Paid Using Soft Dollars

A critical factor in evaluating the Division's claims against Mr. Drennan is his transparency in taking pains to ensure that JSO, Instinet and JSO's attorneys were aware that he was being paid for providing research through Powerhouse. Such transparency negates an inference of scienter. A case on point is *Securities and Exchange Commission v. Shanahan,* 646 F.3d 536 (8th Cir. 2011), where the evidence produced at trial showed that a director had been involved in "backdating" option grants. The court held that there was no primary or secondary liability because the director lacked knowledge that backdating was improper or that a compensation charge was required. The court also emphasized that the director made no effort to conceal his actions, stating that "[T]his transparency is not the behavior one would expect from an intentional or severely reckless violator of the securities laws." *Id.* at 545.

Here, the evidence will show that Howard Rice advised JSO that it was not required to pay hard dollars for the limited non-research activities that Mr. Drennan would provide and that it was possible to pay for the non-research activities in a different fashion. While Mr. Drennan was not an employee of JSO at the time the advice was given, Howard Rice freely shared its advice with Mr. Drennan knowing that he would rely on it.

On one call with Howard Rice, Mr. Mausner asked whether the in-kind compensation that JSO provided to Mr. Drennan, such as the use of a computer and the Bloomberg terminal, telephones, and access to the Internet – the aggregate of which Mr. Mausner valued at significantly more than $12,000 annually – could be considered as compensation by JSO for Mr. Drennan's non-research activities. Mr. Drennan understood the attorney to agree that such compensation would be legally sufficient.

To underscore the point, one of the attorneys who had represented JSO at Howard Rice but then moved onto a different firm, reiterated by email that she believed JSO's disclosure "clearly states" and "spelled out" that soft dollars would be used for products and services that were *not* protected under the safe harbor and would benefit JSO and its General Partner. This reinforces Mr. Drennan's recollection that Howard Rice advised JSO in 2009 and 2010 that it could pay Powerhouse using soft dollars.

3. JSO and Instinet – Not Mr. Drennan – Had the Legal Obligation to Assure That Any "Mixed Use" Soft Dollar Payments Were Appropriate

Fundamentally, with respect to all the payments to Mr. Drennan, whether for research or non-research activities, JSO, as the money manager, had the legal obligation to make a good faith determination as to the reasonableness of such payments. 2006 Guidance, at pp. 47-49. Additionally, Instinet, as the broker-dealer paying for the third-party research, had the obligation to review the description of the services paid for with client commissions under the safe harbor for red flags indicating the services were not within the safe harbor and to agree with JSO to use soft dollars appropriately. Instinet also was required to develop and maintain procedures to ensure that research payments were documented. There is simply no evidence that Mr. Drennan, knowingly or recklessly, prevented JSO or Instinet from performing their legal obligations.

Where soft dollars are used to pay for products or services that have a "mixed use" – where some products or services fall within the safe harbor and some do not – it is ***the money manager's obligation*** to keep adequate books and records reflecting a reasonable good faith determination as to the proper allocation of the soft dollars. 2006 Guidance at pp. 45-46.

There is no evidence that Mr. Drennan engaged in any conduct, much less knowing substantial assistance, that prevented JSO from making such an allocation. Mr. Drennan also was aware of communications with Instinet providing support for Mr.

Drennan's belief that JSO had provided sufficient disclosure to cover the use of soft dollars for non-research activities.

Instinet was aware that Mr. Drennan was providing research services to JSO through Powerhouse. Mr. Drennan provided an IRS Form W-9 to Instinet and expressly discussed Powerhouse with Neil Driscoll of Instinet. Mr. Drennan identified himself on his Linked In website profile as President of Powerhouse and an Instinet employee, Jonathan Ranello, invited Mr. Drennan, through Mr. Drennan's Linked In account, to "link in" with Mr. Drennan in May 2009. When a JSO employee sent an email to Instinet stating that payment for research should be made payable to Mr. Drennan, Mr. Drennan advised her to send a follow-up email to Instinet stating that the payment should be made payable to Powerhouse. Thus Mr. Drennan did not seek to mislead Instinet concerning his provision of research to JSO.

4. Summary

In summary, the evidence at trial will show that Mr. Drennan, who is not an attorney and lacked formal training in the nuances of the legal requirements for soft dollars, had no reason to believe that he was contributing to an illegal scheme by providing Powerhouse invoices to Instinet. He provided research to JSO that came within the safe harbor. He believed that there was sufficient legal support, including JSO's substantial disclosures, for the payments to him for non-research activities. He knew that Instinet was aware of his activities and raised no objection. He was transparent in his dealings with JSO and Instinet. The evidence here is substantially similar to those decisions in which aiding and abetting allegations were rejected because the defendant/respondent lacked conscious knowledge that he or she played a role in furthering an improper scheme. *Matter of Stephen J. Horning,* 2006 SEC LEXIS 2082, at *49-53 (respondent lacked conscious knowledge of principal's violations); *Flynn,* 2006 SEC LEXIS 1766, at *77-91 (respondent participated in market timing activities but had no knowledge they were fraudulent and was not involved in management decisions);

Monetta Fin. Serv., Inc. v. Securities and Exchange Commission, 390 F.3d 952, 956-67 (7th Cir. 2004) (insufficient evidence that defendant was aware of legal requirements for IPO allocations).

Likewise, the evidence would not support a finding that Mr. Drennan substantially assisted or caused any primary violation. Unlike the respondents in the cases discussed above, who were officers or key employees of the registered entity, Mr. Drennan was a third-party with no control over JSO. He was not an officer or employee of JSO. He had no responsibility for maintaining JSO's books and records. Mr. Drennan did not prepare JSO's disclosures or solicit clients for JSO. Mr. Drennan did not direct, nor was he in a position to direct, Instinet to use soft dollars to pay him for his activities. *See In the Matter of Clarke T. Blizzard,* 2004 LEXIS at * 27-29 (aiding and abetting claim rejected where respondent had no compliance oversight responsibilities, and no responsibility for preparing or reviewing public disclosures). Mr. Drennan simply provided research to JSO in exchange for payment that he had every reason to assume complied with the necessary legal requirements.

B. JSO's Payment to Gina Mausner

The OIP also alleges that Mr. Drennan should be liable for JSO's payment of $329,365 to Mr. Mausner's ex-wife and former JSO employee Gina Mausner. OIP ¶¶ 19-23. The evidence at trial will show that this transaction was fully vetted by Mr. Mausner and JSO's attorneys at Howard Rice, who counseled JSO on disclosure issues *and* advised Mr. Mausner in connection with his divorce matters. Mr. Drennan had no substantive involvement with this transaction. The evidence will show that under the circumstances – particularly the deep and prolonged involvement of attorneys at Howard Rice in navigating this payment – Mr. Drennan (who was not even a JSO employee at the time JSO made the payment) had no reason to protest this payment.

1. Mr. Drennan Was Not Aware of the Details of Mr. Mausner's Marital Settlement Agreement

Gina Mausner, who is an attorney, was a co-owner of JSO and had been an employee of JSO. The evidence will show that Mr. Mausner's marital and business relationship with Gina Mausner was complex, spanned multiple years, and involved multiple settlement agreements. Mr. Drennan knew very little about the complicated details of their personal life and the disentanglement of their numerous business and financial interests.

On or around October 31, 2005, Ian and Gina Mausner entered into a Final Executed Marital Settlement Agreement ("Marital Agreement"), providing, *inter alia,* that Ian Mausner would cause JSO to make payments to Gina Mausner in lieu of spousal support, which included payments from January 1, 2006 through December 31, 2006 equal to an annual salary of $250,000, and for the period January 1, 2007 through December 31, 2010, payments equal to an annual salary of $125,000, for a total payment of $750,000. Therefore, as of 2009, a balance remained owing to Gina Mausner.

In May 2009, Ian Mausner told Mr. Drennan that Mausner would request Instinet to make a soft dollar payment in the amount of $329,365.38 to Gina Mausner, apparently representing the remaining amount due under this provision of the Marital Settlement. Mr. Mausner asked Mr. Drennan if he would retype the portion of the Marital Settlement concerning the obligation of JSO to Gina Mausner which reflected a separate, free-standing contract. Mr. Drennan retyped that portion of the Marital Agreement as a separate contract. In doing so, he omitted the statement that JSO's obligation to Gina Mausner was in lieu of spousal support and provisions obligating JSO to pay for certain personal expenses of Gina Mausner, such as membership in a country club, since those expenses were unrelated to the business of JSO and Mr. Mausner had instructed Mr. Drennan only to include the language that pertained to the business of JSO. Mr. Drennan then provided the retyped contract to Mr. Mausner, who then transmitted the contract to Instinet. Instinet agreed to make, and did make, the payment to Gina Mausner.

2. Mr. Drennan Acted With the Reasonable Belief That The Transaction Was Fully Vetted by Counsel and Instinet

Contrary to the Division's assertion, Mr. Drennan acted in good faith and did not have knowledge that he was participating in anything improper. First, Mr. Drennan believed that the Marital Settlement created a valid contractual obligation of JSO to Gina Mausner. Ian Mausner told Mr. Drennan that Gina Mausner had provided consulting services to JSO and had a continuing obligation to provide such services if requested. So Mr. Drennan believed that the payment to Gina Mausner was consideration for services rendered and to be rendered. Further, Mr. Drennan was aware that Gina Mausner had approved the payment by completing a W-9 and that as an attorney and co-owner of JSO, she must have believed that that the payment was for legitimate services rendered to JSO.

Mr. Drennan also received an email from Mr. Ranello at Instinet stating that an opinion of counsel from JSO would be required in order for Instinet to agree to the payment. Mr. Drennan forwarded that email to Mark Whatley at Howard Rice, JSO's outside counsel.[7] As a result of this email, Mr. Drennan believed that Instinet, in ultimately agreeing to make the payment to Gina Mausner, had obtained whatever legal and factual basis it needed for the payment to Ms. Mausner.

Why would he assume otherwise? No one advised Mr. Drennan that Instinet had not obtained an opinion by outside counsel, nor did Mr. Drennan believe that Instinet would make the payment without obtaining such legal authority.

Mr. Drennan was aware that Mr. Mausner had discussions with JSO's outside counsel at Howard Rice, and believed that the attorney had agreed that the soft dollar payment to Gina Mausner was proper. Mr. Drennan also (correctly) believed that Howard Rice had been involved in preparing the Marital Agreement and therefore knew the basis of the proposed payment to Ms. Mausner.

[7] The email in question is the subject of a motion for Protective Order, filed by Instinet on December 18, 2013, which was not yet adjudicated at the time this pre-trial brief was submitted.

Thus Mr. Drennan did not believe that he was participating in a ruse to mislead Instinet into making an illegal payment to Gina Mausner. Rather, he believed that he was being asked to put into a more formal format a valid contractual obligation of JSO to Gina Mausner that was for services rendered and to be rendered; that Instinet had fulfilled its legal obligations by performing appropriate due diligence into the payment; and that Instinet and Howard Rice understood that the payment to Gina Mausner arose from the Marital Settlement.

3. Mr. Drennan Did Not Provide Substantial Assistance With The Transaction

Further, Mr. Drennan's actions could not have provided substantial assistance to any primary violation. His role was ministerial and that of a scrivener, not as a "prime mover" of an illegal action. *See In the Matter of Clarke T. Blizzard,* Admin. Proc. File No. 3-10007-EAJA, 2005 LEXIS 1940, at *24 (July 29, 2005) (record showed that respondent provided substantial assistance where he was "prime mover" in arranging illegal scheme). Mr. Drennan did not make the decision to request Instinet to make the payment nor did he have authority to do so. Mr. Mausner, not Mr. Drennan, transmitted the retyped contract to Instinet with the representation that the contract provided the basis for the payment. Instinet made the decision to provide the payment based on information it obtained from Mr. Mausner. And Mr. Drennan did not benefit from the transaction.

Indeed, given that Mr. Mausner and his attorneys at Howard Rice structured the underlying arrangement with Gina Mausner, initiated and directed the implementation of the transactions, and the disparity of sophistication between Mr. Mausner and Mr. Drennan, it borders on the absurd to contend that Mr. Drennan's actions were vital or provided essential assistance to Mr. Mausner in effecting these transactions.

C. Use of Soft Dollars for JSO's Rent Payments

The Division also alleges that Mr. Drennan is liable for JSO's use of soft dollars to pay the rent for JSO's offices, which also served as Ian Mausner's residence. The

OIP's feeble allegations on this issue merit little response.

As background, JSO occupied the first floor of the premises at 7960 Entrada Avenue in San Diego. Mausner's living quarters were on the upper floor. JSO leased the premises from J.O. Samantha LLC ("JOS"), in which Mr. Mausner was a co-owner. In 2009, Mr. Mausner requested Instinet to use soft dollars to make rent payments to JOS. Mr. Mausner also asked Mr. Drennan to discuss the issue with Instinet.

1. Mr. Drennan Acted With the Reasonable Belief That The Transaction Was Fully Vetted by Counsel and Instinet

Before approving payment of JSO's rent, Instinet requested Mr. Drennan to provide disclosures by JSO that would support the use of soft dollars for rent payments. Mr. Drennan provided Instinet with the August 2008 offering memorandum for the Concentrated Growth Fund, which stated, *inter alia,* that JSO could use soft dollars for such "overhead expenses as office rent, salaries, benefits, and other compensation of employees or of consultants to the Investment Manager, telephone expenses, legal and accounting expenses of the Investment Manager and office equipment and supplies." Exhibit E at INST-4th 025921. Although Instinet did not ask for the prospectuses for other JSO funds, those too contained similar language that clearly disclosed soft dollars may be used to pay rent. *See* Exhibit C at JSO 001354 (offering memorandum for Fund I) (stating that the Investment Manager may cause overhead expenses such as "office space" to be paid "using soft dollars"); Exhibit D at JSO 001141 (offering memorandum for Fund II) (same); Exhibit A at JSO 000384-85 (JSO Form ADV, dated March 30, 2007) (disclosing use of soft dollars to pay for "expenses otherwise payable by the Firm", including "but not limited to" "overhead expenses", which obviously includes rent).

There is simply no evidence to suggest Mr. Drennan was seeking to mislead Instinet. The Division makes much of the fact that JSO's offices were at Mr. Mausner's home. But witnesses from Instinet will testify that in their experience, it was common for investment advisors in the San Diego area to operate their business from home. Mr. Drennan was aware that Instinet employees knew that Mr. Mausner resided at the same

premises that housed JSO's offices. Indeed, Instinet employees visited JSO's offices *in person.*

Instinet clearly knew that the rent payments made with soft dollars were made to an entity controlled by Ian Mausner. They could see that in the Form W-9 provided to Instinet and had copies of the Lease showing that Ian Mausner owned JOS and signed for both JOS and JSO.

2. Mr. Drennan Did Not Provide Substantial Assistance With The Transaction

Finally, there is no evidence that Mr. Drennan provided substantial assistance to any violation. He did not initiate the transaction. He did not compel Instinet to make rent payments (nor could he). And he did not benefit from the transactions.

V. THE DIVISION SEEKS IMPROPER RELIEF AGAINST MR. DRENNAN

The evidence at trial will show that Mr. Drennan did not violate any securities laws. Assuming, *arguendo*, that the Division could prove JSO and Instinet misused soft dollars, the requested relief against Mr. Drennan lacks any basis.

To the extent JSO's use of soft dollars to pay Powerhouse was a technical violation of any soft dollar regulations, that violation enriched JSO, who would have otherwise had to pay that obligation using other funds. Accordingly, any remedy must be directed at JSO and not Mr. Drennan. Curiously, the Division objects to JSO's use of soft dollars to compensate Mr. Drennan on the grounds that he should have been treated as an employee. But the Division has no objection to JSO's payment of its actual employees at the time using soft dollars. This, of course, makes no sense.

To the extent JSO's use of soft dollars to pay its rent or Gina Mausner present any violations of soft dollars regulations, Mr. Drennan did not benefit from those payments, and any remedy arising from those transactions should also be directed at JSO.

The evidence simply does not support any findings against Mr. Drennan. If any findings are made against Mr. Drennan, Mr. Drennan reserves the right to submit a

revised financial disclosure statement pursuant to Rule 630(a) of the SEC's Rules of Practice in order to show his ability to pay any potential disgorgement, interest or penalty. Mr. Drennan previously provided a financial disclosure statement to the Commission. Since the creation of that statement, Mr. Drennan's financial net worth has declined.

VI. CONCLUSION

As detailed above, the evidence at trial will not substantiate any securities laws violations by Mr. Drennan. Throughout 2009 and 2010, Mr. Drennan understood that his role as a third party provider of research to JSO through Powerhouse was both legally compliant and vetted by counsel and other interested parties. Mr. Drennan's specific involvement with transactions which the Division now questions was at the direction of Mr. Mausner and was, to Mr. Drennan's understanding at the time, consistent with the advice obtained from JSO's counsel and transparent to Instinet.

Dated: December 23, 2013

Respectfully submitted,

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EXHIBIT A

EXHIBIT B

EXHIBIT C

EXHIBIT D

EXHIBIT E