RECEIVED
DEC 24 2013
OFFICE OF THE SECRETARY

# PRE-HEARING BRIEF

In the Matter of J.S. Oliver Capital Management, L.P., et al.

Administrative Proceeding File No. 3-15446

Submitted 12/23/2013 by email and U.S. mail

By:

Ian Mausner representing Ian Mausner and J.S. Oliver Capital Management, L.P.

## TABLE OF CONTENTS

INTRODUCTION

**None of the allegations put forth by the Commission have any basis in truth. In fact, the Commission is well aware that black and white proof exists which completely contradicts their allegations. We will show these specifics in great detail during the hearing.**

**Ian Mausner has been a person characterized by generosity, integrity, honesty, loyalty and total devotion to making people's lives better whether it be his clients, friends, family or the many philanthropies he supports. This has been true for his entire 53 years and it would entirely inconsistent with his entire life's conduct for any of these allegations to be true. A person who has constantly been honest, giving, philanthropic, and devoted to clients and friends does not suddenly and abruptly engage in behavior as alleged. It is totally foreign to everything Mr. Mausner has done his entire life and everything he stands for. We will show supporting evidence of this too.**

**As far as the soft dollar issue is concerned, the daily mantra at JS Oliver as constantly repeated by Mr. Mausner was " if it is in our documents, if our lawyers approve it, if our brokers approve it, then let's do it". JSO's intention, without variance, was to always be in compliance with the rules. When Instinet suggested and solicited JSO to expand the relationship into non 28E submissions, the firm did**

so but ALWAYS while relying entirely on counsel. JSO paid Howard Rice hundreds of thousands of dollars to guide them properly in the soft dollar arena and relied on them completely. The soft dollar category is one that is heavily legal, technical and compliance oriented and as such JSO relied on and paid Howard Rice and Instinet to guide them properly. If anything was not done properly by JSO regarding soft dollars it is entirely the responsibility of Howard Rice and Instinet. Both firms were involved and informed of every single transaction.

For the entirety of every single submission, JS Oliver and its employees always sought full approval and vetting from both Howard Rice and from Instinet and the billing records and email records fully verify this as does every single current and former employee of JSO.

An examination of the billing records from Howard Rice shows extensive and numerous consultations and time spent on soft dollars including conference calls and emails. There are literally tens if not hundreds of soft dollar billing entries. JSO and its employees are not lawyers nor are they knowledgeable in all of the details and subtleties of the soft dollar rules and relied entirely on counsel's and broker's guidance and recommendations.

A very important example is the conference call and billing entry exclusively and specifically devoted to the lump sum payment to Gina Mausner. Howard Rice fully vetted and approved this payment. They approved it because Gina Mausner, as the General Counsel and CCO, had an employment contract and a buyout of that contract and a gradual tapering of her involvement was worked out. It was done solely to deal with her employment functions and had nothing to do with the divorce.

Further, Instinet, as evidenced by the email strings, also fully vetted and approved the Gina Mausner expense payment. They had several departments involved, including legal, and Instinet had several conversations with Howard Rice. So, they too, after fully vetting the expense, approved it. Further, every part of her payment was part of her employment agreement with JSO which included among other things payment for an assistant and nanny.

The other specifics presented are equally unfounded: the payment for the St. Regis was an annual payment to exclusively pay for hotel rooms and reduced the cost to the firm by approximately $30,000. So instead of paying a much higher per night rate, JSO's expense was dramatically reduced by paying an annual fee that bought approximately 50-60 room nights. It was purely a business decision to reduce hotel expense. Pure and simple, black and white. Also, this was fully disclosed to both Howard Rice and Instinet and fully approved by both.

As far as the rent is concerned, not only was it fully vetted and approved by Howard Rice and Instinet but such an expense is clearly included in the disclosure language in our documents. One can argue about how much was the fair rent but a 5,000 square foot office with presentation room, entertainment areas, etc commanded a premium rent during the period in question and the rent level was also fully vetted and approved by our counsel. Again, we fully relied on the expertise of our counsel. We raised and then lowered the rent (the SEC conveniently omits the fact that we also lowered the rent) based upon what the firm could afford as well as a fair value for the house.

Re Doug Drennan, firstly Mausner never instructed him to misrepresent or to edit anything. Secondly, Mr. Drennan did perform research for JSO and as such was a perfectly proper submission for soft dollar reimbursement. His non research activity was a negligible percentage of his time. Additionally, submitting his expense was fully vetted through Howard Rice and through Instinet.

Overall, it was Instinet that approached JSO in January of 2009 to begin non 28E soft dollar payments. They were the ones who said that they could do it and encouraged JSO to submit those expenses.

JSO cannot be held responsible for the advice and guidance of its lawyers and brokers who encouraged JSO to do these soft dollar submissions.

**This is a classic example of a complete and pure reliance on counsel situation. The facts are undeniable as are all of the testimony that JSO's intent was to fully and completely abide by the rules and completely relied on the alleged expertise of Howard Rice and of Instinet. JSO paid Howard Rice tens of thousands of dollars to provide sound advice and guidance on their soft dollar activity and relied entirely on that advice. It is Howard Rice and Instinet that is fully responsible for any wrongdoing that occurred. J.S. Oliver, Mausner and Drennan are completely innocent of any wrongdoing.**

**JSO unilaterally ceased all non 28E soft dollar submissions and all single account day trading in 2010 and 2011 respectively. The firm always wanted to do what is right and when these issues were raised, the firm decided to err on the side of eliminating any controversial activity.**

**As far as the trading allocation issue is concerned, the Commission's allegations show a complete lack of understanding of the realities of day trading. Neither the Commission nor their experts ever even inquired about profoundly critical items that directly bear on allocations and on resulting performance. They never even asked about specific client requests about trading, about industries and companies they did not want to own, about risk levels, margin levels, trading frequency, trading risk level, etc. Each of these issues, as we will show with specific trading examples, has a tremendous direct influence on which accounts receive which trades**

and on why certain accounts would have vastly different performance. Omitting all of these considerations is, in fact, the Commission cherry picking itself! They have focused on a few isolated issues and ignored the major contributing factors involved in the allocations.

To illustrate how superficially and inaccurately the SEC reviewed the trading and allocations, we present the following illustration. At various times, especially during the unprecedented market environment during the specified time period, only certain accounts were permitted to be on margin. Obviously those would be the ones empowered and authorized to be on margin and sometimes they would reach their margin limit. Sometimes this would occur intraday, sometimes over night. When such a limit was reached, that account could not receive a buy transaction by rule. This did occur in many occasions and was a determining factor in many allocations. Similarly, for non margin accounts, available cash would limit the ability of those accounts to participate in any trade. This too was a very frequent determinant in trade allocations.

Both of these factors were completely ignored by the analysis of the SEC and a trade by trade examination would show how this consideration of margin buying power and cash availability had a major determining influence on which accounts could participate. In fact, these factors would entirely remove even the possibility of any selective trade allocations.

Another major issue ignored by the SEC is the fact that the CGF fund was set up specifically to benefit from a down market. As such, it has a TOTALLY different approach and philosophy from the other accounts. It has more cash and more put options and these two factors were the primary performance differentiator during the market downturn, not trading allocations!

The other factors mentioned above also figured prominently in the trade allocation decision and were completely ignored by the SEC. They never even asked about them so they could not possibly be aware of them nor factored them into their analysis.

As further illustration: take a client mandate for example to do only a medium level of trading. In such a case as did exist with several of the clients where they did not want full participation and did not want many trades a day but did want to participate in our trading activity, we would only include these accounts in a small percentage of the trades which fit that client's mandate.

Another consideration also completely ignored by the SEC is the size of the account and therefore the possible size of the trade that could be done in the account. For example, a $10 million account cannot do a $20 million trade both because of the undue risk and lack of buying power. So certain larger trades could only be allocated to a very few of the larger accounts and sometimes only to one or two qualifying accounts. In these circumstances, there would be no possibility of any selective allocation!

Several accounts had overall mandates as well as some specific directives none of which were even requested by the SEC so they could not possibly have included it in their analysis of the trading. For example, if a client gave us a directive not to own gaming or tobacco stocks then that account would not be included in those trades. None of the general or specific client directives were even considered by the SEC which is a major error in their approach.

All of our trading policies and approach was vetted by our counsel. We specifically discussed what we were doing in our trading and how we were allocating trades and it was fully approved by Howard Rice. As such, we fully relied on counsel that our approach was fully acceptable and legal.

So overall, when one examines each trade, as one must since they cannot be looked at in one brushstroke, a clear picture evolves of a fair and considered approach to the trading, where a reasonable explanation exists for each and every trade. Especially during the highly volatile market days, client risk profile, margin buying power and limitations brought on by cash levels all played a huge determining role in allocations all of which were entirely ignored by the SEC. Not only is this an

**outrageous and negligent omission but examination of it is entirely exculpatory of JS Oliver and its employees.**

**The Commission put forth a dollar amount of the total amount involved in day trading which is inaccurate. The total is, in fact, considerably less and even if every single trade was not properly allocated, the resulting performance impact on the accounts the Commission alleges were harmed would have been non material and insignificant. It literally would be a rounding error compared to the performance of the non trading positions. So even if some of the allegations were true, which they are most definitively not, the impact on the accounts in question is of no consequence financially and performance wise. All this will be clearly illustrated in the hearing.**

**As we will show, Mr. Mausner never personally benefitted from any of these alleged activities. In fact, he always had a net loan to JSO and does to this day. He never had a net inflow of funds to his benefit.**

**The ideal of innocent until proven guilty has been viciously abused in this case and, as such, Ian Mausner and J.S. Oliver have already been punished and have paid dearly both financially and reputationally without ever having had their day in Court.**

**Over the course of the Commissions's audit, investigation and filing of the complaint the following occurred:**

**Clients were called and sent letters which caused undue and undeserved client defections.**

**Concurrent with the filing of the complaint, the Commission issued a press release which went into great detail about the allegations resulting in the following:**

**JSO's prime broker, Merlin Securities, owned by Wells Fargo, terminated the relationship and**

**Schwab, JSO's prime broker for all of their separate accounts, terminated the relationship. This has put the viability of the business into serious question.**

**The many years that the Commission took to conduct this inquiry and the accompanying requests for documents from JSO, which now total over 1 million pages, have drained all of the firm's and of Mr. Mausner's resources. As a result, Mr. Mausner and JSO were forced to represent themselves and funds were not available to pay for any expert testimony, though we all know that expert testimony is highly apocryphal.**

**Reputationally the impact is devastating as in any Google or other internet search, the Commission's filing and allegations appear at the top and are repeated multiple times in the first few pages. In this day and age, the impact is devastating in all areas of life including such critical items such as opening bank accounts, mortgages,**

**philanthropic activities, social activities and any application for virtually anything.**

**How can this be fair to have suffered such harm before having our day in Court?**

## I. BACKGROUND

JSO was founded by Mr. Mausner in 2003 to manage private investment funds as well as individual accounts. JSO is registered with the Commission as a "large advisory firm," with assets under management of over $100 million. JSO's individual account clients are all high net worth, accredited investors, foundations, trusts and IRA's, except for a few personal friends and family of Mr. Mausner. During the time period focused on in the Commission's pending investigation of JSO and Mr. Mausner ("the Investigation"), approximately mid-2008 through 2010, JSO was the investment manager for four private investment funds: J.S. Oliver Investment Partners I, L.P. ("IP1"); J.S. Oliver Investment Partners II, L.P. ("IP2"), J.S. Oliver Concentrated Growth Fund, L.P. ("CGF"), and J.S. Oliver Offshore Investments, Ltd. ("OI") (collectively, "Funds").

J.S. Oliver Holdings, LLC, is the general partner of JSO. Mr. Mausner is a 50% member of J.S. Oliver Holdings, LLC, of which Stuart Feldman is the other 50% member. Messrs. Mausner and Feldman each own 49.5% of JSO as limited partners thereof as well. Mr. Mausner is also Chief Executive Officer and Senior Portfolio Manager for JSO.

Mr. Mausner has been a money manager and financial advisor for over twenty years. Prior to founding JSO, Mr. Mausner was with Montgomery Securities (now Banc of America Securities) for ten years, where he was a Managing Director and one of the original members of the Private Client Services Department. From 1989 until 1993, prior to joining Montgomery Securities, Mr. Mausner was with Kidder Peabody as a Senior Vice President. Mr. Mausner was with Morgan Stanley from 1985-1989 in similar capacities. Mr. Mausner received his M.B.A. in 1985 from Stanford Business School with an emphasis in Investment Management and Finance and received his B.A.

degree in Economics from Amherst College in 1982. Mr. Mausner has never been the subject of any regulatory action during his lengthy tenure in the securities industry.

## II. SOFT DOLLARS

### A. JSO and Mr. Mausner Relied Upon and Followed the Extensive Advice of Its Outside Counsel with Regard to the Detailed Disclosures Made Concerning the Use of Soft Dollars

JSO sought and received extensive legal advice with regard to its soft dollar use from two highly regarded law firms, Howard, Rice, Nemerovski, Canady, Falk & Rabkin, PC ("HR") (succeeded by Arnold & Porter) and Pillsbury Winthrop Shaw Pittman LLP ("Pillsbury"). During the period at issue in this investigation, Mark Whatley, a partner specializing in hedge-fund regulatory advice, was the primary partner contact at HR with regard to securities law issues. Mr. Whatley's involvement included, among other things, extensive discussions with Mr. Mausner and others at JSO regarding soft dollar issues. Attached hereto and incorporated herein by reference as **Exhibit "A"** is a true and correct copy of a HR billing statement to Mr. Mausner for legal services provided in May 2009, produced in this investigation by JSO as "JSO 299861." The statement includes an entry for May 15, 2009, in which Mr. Whatley bills for an approximately twenty-minute "[t]elephone call with I. Mausner regarding soft dollar questions." [See Exhibit A.] This call concerned the payment to Gina Mausner for consulting services discussed in Section III.C, below.

HR drafted and revised the Form ADV ("ADV")for JSO and the offering memoranda for the Funds ("Offering Memoranda") as HR determined to be necessary, and JSO relied upon HR to decide when it was necessary to revise these documents and what should be included in such documents. As described below, these documents contained extensive soft dollar disclosures drafted, reviewed and revised by counsel. Mr. Mausner informed HR that all individual accounts and all of the Funds would be subject to soft dollar use. Accordingly, all Offering Memoranda for the Funds included full and complete soft dollar use disclosure as did the ADV, which was provided to all individual account holders and filed with the SEC. Mr. Mausner and others at JSO spoke with Mr. Whatley and other attorneys at HR many times to provide the needed information and to receive advice as to how to comply with applicable securities laws. There were numerous such calls.

As advised by counsel, the ADV was provided to all individual account clients of JSO, as well as all of the investors in the Funds, as an attachment to the Offering Memoranda. The Offering Memoranda also included a soft dollar disclosure substantially identical to that in the ADV, as further discussed below. JSO also entered into investment management agreements with the individual account investors which included Part II of the ADV, including the soft dollar disclosure, as an attachment. Updated ADV's were made available to investors as instructed by counsel.

The extensive involvement of HR in drafting and revising these disclosure documents is attested in the documentary record produced in this investigation. Attached hereto and incorporated herein by reference as **Exhibit "B"** is a true and correct copy of an email string from December 2005 – January 2006, produced by Arnold & Porter, as "AP000014-16." Exhibit B shows Bernard J. Kwasniewski, a partner with HR, communicating with Lindsey Back, Executive Administrator at JSO, as to recommended revisions to the Offering Memoranda, including that the "Soft dollars section may need to be removed or modified." [See Exhibit B.] Ms. Back responded that she would confirm with Mr. Mausner that he had discussed such proposed revisions in a "conversation with Mark [Whatley]." [See id.] Attached hereto and incorporated herein by reference as **Exhibit "C"** is a true and correct copy of a HR billing statement to Mr. Mausner for legal services provided in March 2007, produced in this investigation by JSO as "JSO 299835." The statement shows extensive work by HR partners such as the abovementioned Mr. Kwasniewski and Ildicko Duckor, on revisions to the ADV for JSO. [See Exhibit C.] Attached hereto and incorporated herein by reference as **Exhibit "D"** is a true and correct copy of an email from Mr. Kwasniewski to Lindsey Back of JSO, dated June 15, 2006, produced by Arnold & Porter as "AP000039-000048," attaching his revised versions of the Offering Memoranda for the three Funds in existence at that time, IP1, IP2 and OI. Attached hereto and incorporated herein by reference as **Exhibit "E"** is a true and correct copy of an email from Ms. Aquino of HR to Ms. Back, dated March 29, 2007, produced by Arnold & Porter as "AP000068-72," attaching "a redline of [Form ADV] Sched F with Bernard's [Kwaniewski] changes to soft dollar section . . .."

Ms. Duckor also worked extensively on the Offering Memoranda, including the initial memorandum for CGF, established in or around July –August 2008. Attached hereto and incorporated herein by reference as **Exhibit "F"** is a true and correct copy of a HR billing statement to Mr. Mausner for legal services provided in July 2008, produced in this investigation by JSO as "JSO 299843." The statement shows Ms. Duckor billing over 18 hours in preparing the CGF Offering Memorandum and related offering documents and communicating with Mr. Mausner concerning the documents. [See Exhibit F.] Other partners and associates at HR also advised JSO as to its soft dollar use and disclosures. Anita Krug, at the time partner of HR, was among them. Attached hereto and incorporated herein by reference as **Exhibit "G"** is a true and correct copy of a HR billing statement to Mr. Mausner for legal services provided in August 2009, produced in this investigation by JSO as "JSO 299864." Included on Exhibit G is an entry for Ms. Krug's discussion with Doug Drennan regarding "IA registration and soft dollar issues." [See id.]

During the time period of the non-28(e) activity at issue herein, the ADV disclosed, in relevant part, the following:

**"Soft Dollars"**

The Firm may select Transacting Parties in recognition of the value of various services or products, beyond transaction execution, that they provide to Clients, the Firm or its affiliates. Selecting a Transacting Party in recognition of the provision of services or products other than transaction execution is known as paying for those services with "soft dollars." Because many of those services and products could benefit the Firm or its affiliates, the Firm may face conflicts of interest in allocating Clients' securities transactional business . . . [listing various potential conflicts] . . .. The investment management agreements for the Clients authorize the Firm to use Clients' soft dollars for a wide range of purposes, notwithstanding the conflicts of interest those uses may involve. The extent of the conflict of interest arising out of the use of soft dollars depends in large part on the nature and uses of the services and products acquired with soft dollars, which may include the items discussed below.

. . . [disclosure regarding 28(e) research and brokerage soft dollar use] . . .

*Other Services and Products*

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, as it will have an incentive to use Transacting Parties who provide or pay for products and services for which the Firm would otherwise have to pay cash and, if soft dollars are limited, it may have an incentive to cause those expenses to be paid with soft dollars while the Funds pays *[sic]* their own expenses with cash.

[See March 30, 2007 Form ADV, Part II, Continuation Sheet, Items 12 & 13, a true and correct copy of which is attached as **Exhibit "H"** hereto.] The above disclosure in the Form ADV of March 25, 2009 was substantially identical. The 2006 versions of the offering memoranda for the IP1, IP2 and OI, which were operative until revised in 2011, carried substantially identical disclosures to those above.

The March 2011 Form ADV was, on advice of counsel, revised to include a still more explicit disclosure of soft dollar use, including but not limited to the following:

> ***Other Services and Products.***
>
> Non-research or non-brokerage services that a Transacting Party may provide could potentially include . . . out-of-pocket expenses involved in soliciting prospective investors (including finders' fees or placement agent fees) and in evaluating potential investment opportunities (including travel, meals, and lodging related to such evaluation . . . such "overhead" expenses as office rent, salaries, benefits and other compensation of employees or of consultants to the Firm . . ..

[See March 2011 Form ADV, Part 2A, p. 11, a true and correct copy of which is attached as **Exhibit "I"** hereto.]

The offering memoranda for the IP1, IP2 and OI Funds were also revised accordingly in 2011. Ms. Duckor, who had moved to Pillsbury from HR, had taken over review and revisions to JSO's disclosure documents after Mr. Whatley had moved from HR to Sidley Austin. As shown in Exhibit F, discussed above, Ms. Duckor had also drafted the initial offering memorandum for CGF, which was established in 2008. As such, the CGF Offering Memorandum carried a disclosure substantially identical to those in the 2011 versions of the Offering Memoranda for the IP1, IP2 and Offshore Funds. Attached hereto and incorporated herein by reference as **Exhibit "J"** is a true and correct copy of a Pillsbury billing statement for JSO concerning work performed in March 2011, produced in this investigation as JSO 299873, including an entry for "Revisions to offering memoranda (soft dollar and regulatory updates)." Ms. Duckor not only drafted and revised these disclosures regarding soft dollars, but she assured JSO that its existing disclosures (i.e., prior to her revisions) were sufficient for the soft dollar activity in which JSO was engaged. Attached hereto and incorporated herein by reference as **Exhibit "K"** is a true and correct copy of an email string between Ms. Duckor and Ms. Kartes, dated April 26, 2011, produced in this investigation as "JSO 299959 – 299961." In Exhibit K, Ms. Duckor states:

> I would like to reiterate that the spirit of the entire soft dollar disclosure and its global message very clearly communicate an aggressive soft dollar policy that uses non-28(e) type services and products that benefit the Investment Manager and its affiliates. The disclosures are both broad in scope and detailed in the particulars. The related conflicts between the Investment Manager and its affiliates on the one hand, and the Fund and investors on the other, are also spelled out in detail.

[See id.] Thus, as JSO and Mr. Mausner were extensively advised by counsel, that the soft dollar use at issue in this investigation was lawful and fully disclosed to investors and the Commission. There is further discussion below, in Section III, of certain soft dollar categories of apparent interest to the Commission staff that has conducted the Investigation ("the Staff").

### B. Instinet Instigated JSO's Use of Non-28(e) Soft Dollars and Vetted JSO's Soft Dollar Activity with Its Own Counsel

JSO did not use soft dollars for expenses falling outside the safe harbor of Section 28(e) of the Exchange Act ("non-28(e) expenses") until it was suggested to JSO by Instinet LLC, which became a broker for JSO in or around December 2008. In or around early 2009, JSO sent Instinet an invoice for outside research regarding proxy voting, believing it may fall within 28(e) allowed research. Instinet responded that the expense did not fall within 28(e), but stated that JSO may be able to use soft dollars for non-28(e) expenses. Neither Mr. Mausner nor Mr. Drennan had ever considered using soft dollars for non-28(e) expenses. However, as Instinet was a major brokerage firm, Mr. Mausner believed it was worth looking into as long as JSO's counsel approved.

JSO provided an example of its soft-dollar disclosures to Instinet in February 2009. Attached hereto and incorporated herein by reference as **Exhibit "L"** is a true and correct copy of an email from Mr. Drennan to Instinet, dated February 9, 2009, produced by JSO as "JSO 324033-324095," attaching the CGF Offering Memorandum. Thus, in addition to the vetting of the soft dollar activity by JSO's own counsel, there was extensive vetting of the activity with Instinet's counsel, including direct communications between JSO and Instinet's counsel.

Moreover, Instinet consulted its counsel when new types of expenses were proposed for soft dollar treatment. In May 2009, when JSO considered soft dollar treatment of a lump sum payment of compensation owed to Gina Mausner (further discussed in Section III.C, below), Instinet's counsel weighed in on the matter as well. JSO had direct communications with Instinet's in-house counsel, Alice Kenniff, on the matter, providing her the information she requested for approval of soft dollar treatment.

In addition, Mr. Ranello of Instinet forwarded to JSO the Instinet staff's email consultation with Ms. Kenniff with regard to the Gina Mausner payment. Attached hereto and incorporated herein by reference as **Exhibit "M"** is a true and correct copy of an email string from May 8, 2009, including internal Instinet emails and the forwarding of such emails to Mr. Drennan at JSO ("the Instinet Email"), produced by JSO in this investigation as "JSO 299951-299954." [See Exhibit M.]

Instinet has argued that the Instinet Email contains attorney-client privileged communications transmitted by "a junior employee of Instinet, without Instinet's authorization." [See April 30, 2012 letter from Wilmer Hale, attorneys for Instinet, to Freeman Freeman & Smiley, LLP, attorneys for JSO and Mr. Mausner, copied to you and others at the Commission.] As stated in your July 16, 2013 email to me, the Staff will not act as "arbiter" of the privilege issue and the Staff will not consider the Instinet Email "until determined otherwise by Instinet, a court, or an ALJ. It is puzzling that the Staff chooses not to act as "arbiter" of this privilege issue though the Staff routinely decides such issues during investigations. Moreover, it is the proponent of the privilege, Instinet, that bears the burden of establishing the existence of the privilege and taking any action that is necessary to protect its assertion of privilege over a document that it voluntarily provided to our clients over four years ago. The fact that Instinet has not done so is further evidence that any potential privilege has been waived. (See discussion below regarding applicable case law). The only action Instinet has taken is having its counsel sending two letters to our office, including the April 30, 2012 letter on which your office was copied, citing a single inapplicable case. (See discussion of case law below). Even Instinet has not demanded of our clients what the Staff is demanding. In its April 30, 2012 letter, Instinet requested that our clients "refrain from disclosing this document to *any other party* [other than the Commission] without first providing Instinet with an opportunity to be heard in opposition to such production." Instinet's counsel clearly understands that Instinet has the burden of taking action to protect any privilege assertion.

Further, we do indeed believe that that contents of the Instinet email are "critical to the Staff's assessment of its case" as well as the Commission's assessment. This email is critically relevant not only to the 2009 payment to Gina Mausner, which is a focus of the Staff's investigation, but also critically relevant to the assessment of the advice of counsel defense and the scienter issue. There are few emails between Mark Whatley of HR and JSO, as the vast majority of the communications were by telephone, which is very common in attorney-client communications and relationships. The Instinet Email, however, was forwarded by Mr. Drennan to Mr. Whatley (See Exhibit "M"), and this was followed up by an email from Mr. Drennan requesting a call with Mr. Whatley to "discuss the classification of the payment" (See Exhibit "N," described below). Thus, the Instinet Email provides corroboration of Mr. Mausner's testimony and powerful documentary evidence supporting the advice of counsel defense and negating scienter. It is among the most important documents produced by JSO in the Investigation, and it is very important that the Staff and the Commission consider it before filing any action.

JSO and Mr. Mausner submit that the Instinet Email is not subject to any privilege and should be fully considered by the Commission before filing any action in this matter, Instinet's privilege objection notwithstanding. The Instinet Email constitutes substantial evidence of two critical points: (1) that Instinet's in-house counsel vetted JSO's soft dollar activity before they would allow processing of JSO's soft dollar invoices and (2) that JSO consulted HR before submitting any soft dollar expense to Instinet that was of a nature that had not been done by JSO previously. The Instinet Email includes an email from Alice Kenniff, an in-house attorney of Instinet, to Maureen Shankar of Instinet. [See id.] In response to Ms. Shankar's request for guidance as to what information would be needed from JSO for Instinet to be comfortable with processing the payment to Gina Mausner (which payment is further discussed in Section III.C, below). [See id.] Ms. Kenniff responded that JSO should provide a copy of the consulting agreement entered into with Ms. Mausner and "an opinion from their counsel" stating that the payment is allowed under the relevant disclosures in the

Funds' Offering Memoranda. [See id.] This instruction was forwarded to Jonathan Ranello, who regularly interfaced with JSO with regard to soft dollar payments, and he forwarded it on to Mr. Drennan. [See id.] Mr. Drennan forwarded the email string to Mr. Whatley. [See id.] Mr. Drennan followed this up with a call to Mr. Whatley, as described in Mr. Drennan's subsequent email to Mr. Whatley. Attached hereto and incorporated herein by reference as **Exhibit "N"** is a true and correct copy of Mr. Drennan's May 8, 2009 email to Mr. Whatley, produced in this investigation by JSO as "JSO 299956," in which Mr. Drennan requests a call "to discuss the classification of the payment." In response to Exhibit M, Mr. Mausner provided an excerpt of the pertinent terms of the consulting agreement, produced by JSO as "JSO 324096-324098." Attached hereto and incorporated herein by reference as **Exhibit "O"** is a true and correct copy of Mr. Mausner's email to Instinet of June 1, 2009, attaching an excerpt of the relevant portions of the consulting agreement. Accordingly, the Instinet Email is highly relevant to the analysis of the soft dollar issue, particularly with regard to the scienter element of the antifraud statutes, as further discussed in Section IV, below.

There is no privilege preventing the Commission from considering the contents of the unredacted Instinet Email. The Instinet Email was either (1) never privileged or (2) the privilege was waived by Instinet when it voluntarily provided the email to JSO.

In its April 30, 2012 letter, Instinet's counsel cites *U.S. v. Chen*, 99 F.3d 1495, 1502 (9th Cir. 1996) for the proposition that "a corporate employee cannot waive the corporation's privilege . . .." *Id. Chen* is entirely distinguishable from the present instance. The case involved an employee who took a box of documents containing attorney-client communications, unbeknownst to her then employer, to turn them over to U.S. Customs. *Id.* at 1498. Thus, there was no issue in *Chen* with regard to the corporation's lack of diligence in keeping the allegedly "privileged" communications confidential, which is a decisive issue in the case of the Instinet Email. Moreover, the communications at issue were between the owners of the company (which was a small company) and outside counsel, and the employee at issue was apparently not included on the communication. *Id.* Thus, the case did not raise the particular privilege and waiver questions raised by the Instinet Email. The analyses of existence of privilege and waiver of any such privilege are more complex where the communications themselves include lower level employees in a larger company and particularly where the communications involve in-house counsel, as they do with the Instinet email.

In *Jonathan Corp. v. Prime Computer, Inc.*, 114 F.R.D. 693 (E.D. Va. 1987), the district court held that the voluntary production of a privileged memorandum by a marketing representative of the defendant corporation to a customer of that corporation waived the privilege. *Id.* at 700. The memorandum was prepared by the defendant's in-house attorneys for the branch administrator of the corporation. *Id.* at 694. The memorandum was not marked confidential or privileged. *Id.* The memorandum was distributed to five individuals in the company other than the branch administrator, as indicated on the face of the memorandum. *Id.* The other individuals included a market representative of the defendant corporation who was solely responsible for the plaintiff customer's account with the defendant. *Id.* at 694-695. In the midst of a contract negotiation, the market representative on his own initiative provided the memo to a representative of the customer, and they discussed the memo. *Id.* at 695, n. 2. The memorandum supported the position taken by defendant corporation in the contract dispute, and the market rep had provided it to plaintiff customer in support of defendant's argument. *Id.* No litigation was ongoing or contemplated at the time. *Id.* Subsequently, litigation arose, and the defendant corporation took the position that the memo was privileged. *Id.* at 694.

The district court cited the landmark Supreme Court case in the area of corporate attorney-client privilege, *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981), which held that communications between a corporation's in-house counsel and employees, even lower-level employees, may be privileged. *Id.* at 695. The first question under the analysis is whether the internal communication is intended to constitute a confidential communication for the purpose of seeking or providing legal advice. *Id.* at 696. If so, then the privilege attaches. *Id.* Then, a second question arises – whether the voluntary production of the memorandum by an employee to a third party constitutes a waiver. *Id.*

The district court skipped to the second question, the question of waiver, as dispositive of the issue, thereby obviating a detailed analysis of the privilege question. *Id.* at 696-697. The court noted, however, that it had "serious doubts" as to whether the memo was intended to be confidential. *Id.* at 696, n. 6. The failure to mark the memorandum as confidential, coupled with the fact that it was distributed to six employees, indicated a lack of intent to maintain confidentiality. The lack of intent indicated a lack of any privilege to begin with. *Id.*

With regard to waiver, the court noted that even an inadvertent disclosure of privileged documents may waive the privilege if the party did not "take reasonable steps to insure and maintain [their] confidentiality." *Id.* at 697 (further citations omitted here). The court found that it was questionable whether the defendant corporation had taken any steps at all to insure confidentiality of the memo. *Id.* The court rejected the argument that the marketing representative, as a lower-level employee, did not have the power to waive the privilege on behalf of the corporation. *Id.* at 697-698. The court found that the defendant corporation voluntarily produced the memo during the ordinary course of business dealings and without any reservation of the privilege. *Id.* at 699.

Though the *Jonathon Corp.* case is from the Fourth Circuit, it has been followed in the Ninth Circuit. In *Truckstop.Net, LLC v. Sprint Corp.*, 2006 WL 851129 (D. Id. 2006), the district court found the reasoning of *Jonathan Corp.* "persuasive." *Id.* at *1. The district court rejected the defendant's narrow reading of the Ninth Circuit case *Chen, supra*, as holding that no non-management employee could ever have authority to waive the privilege. *Id.* The court noted that the *Chen* court had inquired as to whether the employee had been given authority to waive the privilege, which it would not have done if there were a blanket rule that no non-management employee could ever waive the privilege. *Id.* The court further noted that, in the landmark Supreme Court case of *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 348 (1985), the Supreme Court had stated that the power to waive the privilege is "*normally* exercised by its officers and directors." *Id.* (quoting *Weintraub, supra,* at 348) (italics in original). The use of the qualifier "normally" indicated to the district court that, under some circumstances, waiver could be exercised by non-management employees. *Id.* Thus, the district court held that a salesman for the defendant corporation who had been copied on a memo by in-house counsel had waived the privilege on behalf of the defendant corporation by providing it to plaintiff customer. *Id.* at *2. The court also adduced a second "independent" reason for the ruling – that the defendant did not "act aggressively and promptly in seeking return of the document." *Id.* at *2.

The situation of the Instinet Email is in all relevant respects the same as those in *Jonathon Corp.* and *Truckstop.Net* cases. Jonathan Ranello, the lower level employee at Instinet who sent the Instinet Email to Doug Drennan at JSO, was frequently in contact with JSO on soft dollar issues. Like the market representatives in the above cases, Mr. Ranello was apparently assigned by Instinet to handle JSO soft dollar payments. Accordingly, it was foreseeable by Instinet that communications provided to Mr. Ranello would be provided to JSO. Moreover, there was no "privilege" or "confidential" marking on the Instinet Email. The email from the attorney, Alice Kenniff, was an instruction as to what JSO should be asked to provide to Instinet, so it would also be foreseeable that the email, particularly because it was in the form of an email, would be forwarded on to JSO as part of such a request. Finally, Instinet took no action to retrieve or otherwise enforce its privilege position for almost three years after it was sent, and only after it became an issue in the SEC's investigation of Instinet. According to the Truckstop.Net decision, this is a sufficient basis in and of itself to disregard any privilege claim. See *Truckstop.net, supra*, at *2.

There are additional facts with regard to the Instinet Email that were not apparently present in the *Jonathon Corp.* or *Truckstop.Net* cases, that make Instinet's privilege claim even weaker than the privilege claims in those matters. Alice Kenniff herself had direct communications with JSO on this very soft dollar issue – the payment to Gina Mausner. In the cases cited above, it was sufficient that the lower-level employee had been the employee assigned to the customer's account, which is true in this case. Here, however, the attorney herself also had direct contact. Further, the Instinet Email is for the purpose of helping both Instinet and JSO comply with regulatory requirements. So, Instinet and JSO were aligned in interest for this purpose, and it is clear that Instinet did not have any desire to keep the communications confidential vis-a-vis JSO. In the *Jonathan Corp.* case, on the other hand, the memorandum at issue actually concerned an ongoing contractual dispute between the parties, so an expectation of confidentiality was more likely in that matter than it was with regard to the Instinet Email.

Therefore, Instinet's privilege claim with regard to the Instinet Email must be rejected. The Instinet email was either (1) never intended to be a confidential communication, and thus, not privileged, or (2) if it was privileged, Jonathan Ranello effectively waived the privilege on behalf of Instinet by providing it to JSO.

## III. PARTICULAR USES OF SOFT DOLLARS OF APPARENT INTEREST TO THE STAFF

The following is a more detailed discussion of particular uses of soft dollars which have been of apparent interest to the Staff in the Investigation.

### A. Soft Dollar Payments for Business Travel Expenses

The Staff takes issue with regard to soft dollar payments made concerning a fractional ownership interest in a hotel that was used for JSO business travel. At the outset, it should be noted that Mr. Mausner personally paid out of his own pocket over

$500,000 for the fractional ownership interest despite the clear benefit to JSO. Attached hereto and incorporated herein by reference as **Exhibit " P"** are true and correct copies of escrow file documents concerning the purchase. The hotel ownership interest saved JSO a substantial amount of money by avoiding the cost of booking hotel rooms in New York. Mr. Mausner travels frequently to New York on JSO business – around 20-40 times per year. Mr. Mausner estimates that the purchase of the suite saved JSO hundreds of dollars per night in New York lodging costs. The hotel room was also used for JSO business meetings.

As noted above, the vast majority of the cost of the suite, the purchase price itself, was paid by Mr. Mausner personally from his own funds even though it was primarily for business use. Mr. Mausner paid approximately $526,158 for the purchase. The only cost related to the interest that was paid with soft dollars consisted of annual maintenance fees and property taxes of approximately $18,000.

Mr. Mausner has never used the hotel room for a personal vacation. He uses the room for meetings with investors and potential investors, as it has a living room appropriate for meetings. He also uses his New York trips to analyze competitors and potential investments. Any personal use has been immaterial and incidental, a de minimis portion of trips devoted to JSO business. Mr. Mausner discussed the business use of the room with the hotel management before entering into the purchase agreement and was told this type of business use is common.

The maintenance fee / property tax soft dollar expense was approved by HR before the invoice was submitted to Instinet, which also approved the expense. Mr. Mausner had initially planned to treat this as an expense to JSO until HR suggested soft dollar treatment. HR analyzed this issue and reviewed the invoice before giving approval. Travel expenses are clearly covered by the disclosures to investors in the ADV and Offering Memoranda, as described above.

### B. Soft Dollar Payments to Powerhouse Capital

The Staff also takes issue with regard to soft dollar payments made to Doug Drennan and, subsequently, his consulting firm, Powerhouse Capital ("Powerhouse"), for research services provided to JSO. Mr. Mausner consulted with HR as to whether such activity fell within the safe harbor of 28(e) for research and brokerage activity. After discussing the issue with Mr. Mausner and Mr. Drennan, HR advised that the activity was within the safe harbor. Instinet also agreed that the activity was within the safe harbor

In analyzing the issue, HR considered the question as to whether Powerhouse was truly independent as Powerhouse had only JSO as a client and worked out of the JSO office. Mr. Whatley advised that the critical factor for determining whether the consulting firm was independent was that it sought in good faith to find other clients, even if it was unsuccessful in doing so. Mr. Drennan informed Mr. Mausner that he was looking for other clients, but was unsuccessful. For example, Mr. Drennan informed Mr. Mausner that he had met with his former hedge fund employer, Dan Wimsatt, and other small hedge fund managers, but these meetings did not lead to any work for Powerhouse. This was, of course, late 2008 - early 2009, when the markets were in extreme turmoil.

HR also considered the question of whether Mr. Drennan could provide incidental administrative services to JSO while he was at the JSO office. Counsel advised JSO that Mr. Drennan could perform administrative services for JSO so long as the services were immaterial – i.e., less than 10% - and Mr. Drennan was not compensated for such incidental services. Mr. Drennan spent well over 90% of his time doing research and was not compensated for the incidental administrative services, so HR approved the soft dollar treatment. Mr. Drennan was not an employee of JSO during the period that Powerhouse provided consulting services. He had no business cards for JSO, and he did not answer the phone for JSO. He did not hold himself out as representing JSO.

Mr. Drennan made an effort to refrain from communicating with JSO clients during the Powerhouse period.

The nature of the research performed was that of daily sharing of ideas on stocks but some research regarding fixed income investments as well. Mr. Mausner gave Mr. Drennan assignments regarding issues for research. Mr. Drennan was well qualified to provide this service. Mr. Drennan earned a B.S. degree in Finance from the University of Illinois and is a Charter Financial Analyst (CFA) charterholder issued by the Association of Investment Management and Research (AIMR). He had previously worked as Senior Portfolio Manager and a key member of the research team of YCMNET Advisors, Inc., a registered investment advisory firm. Mr. Drennan was responsible for managing the operational research, portfolio review, and trading processes at YCMNET. Mr. Drennan also worked at Merrill Lynch as an International Economist in the Fixed Income department focusing on analysis and trading in global futures contracts and options in government securities. Mr. Drennan was selected and trained through Merrill Lynch's International Training Program focusing on global asset allocation, equity and fixed income analysis, and other specialized topics. Mr. Drennan also has worked for Toronto Dominion Bank (parent firm of TD Waterhouse) in Quebec, Canada managing their global fixed income sales team trading for institutional clients, where he was responsible for structuring options and future contacts in bond basis situations (a specific form of arbitrage). Thus, Mr. Drennan was eminently qualified to provide research to JSO and did so.

**C. Soft Dollar Payments to a Consultant (Gina Mausner)**

The Staff takes issue with a soft dollar payment of $329,365.38 made to a consultant (Gina Mausner) in June 2009. Ms. Mausner was integral to forming JSO. She was JSO's general counsel and chief compliance officer at the beginning of the company and later became a consultant to the company.

Mr. Mausner and Ms. Mausner divorced in or around October 2005, reaching a settlement with division of property. The 2005 settlement included the provision that Ms. Mausner would continue to be CFO and General Counsel of JSO for five years (with possibility of renewal) and would continue to receive a salary and benefits comparable to that she had received before. Ms. Mausner would be available to review financial statements, deal with tax issues and handle other duties which she had been handling for JSO.

In or around May 2009, Ian Mausner and Gina Mausner modified the 2005 settlement agreement. The modification provided for the end of the professional relationship between Ms. Mausner and JSO, and the lump sum payment of amounts owed to her under her agreement for services with JSO. As employee compensation and payments to consultants were subject to soft dollar treatment at the time, JSO approached counsel, Mr. Whatley, to inquire if such a payment could receive this treatment. Mr. Mausner had numerous telephone calls with Mr. Whatley concerning this issue, and Mr. Drennan was involved in the discussions as well. [See Exhibit N.]

Mr. Whatley advised that, as compensation was eligible for soft dollar treatment, the payment to Ms. Mausner was as well. Mr. Whatley said that such payments were included in the investor disclosures, and so soft dollar treatment was acceptable. Mr. Whatley was intimately familiar with the terms of the 2009 agreement as he was involved in the negotiation of the agreement. Attached hereto and incorporated herein by reference as **Exhibit "Q,"** is a true and correct copy of a May 6, 2009 email from Mr. Whatley to Sharon Kalemkiarian, Esq., family counsel for Mr. Mausner, in which Mr. Whatley included a list of proposed revisions to the agreement, produced by JSO in the Investigation as "JSO 299882-299885."

As discussed in Section II.B, above, Instinet also reviewed this soft dollar issue with its counsel and received information from Mr. Mausner with regard to the agreement. [See Exhibits M & O.] Counsel also instructed Mr. Mausner to send one of the Offering Memoranda to Instinet so that their counsel could review the soft dollar disclosure. Mr. Mausner did not send the ADV because he was not instructed to do so by counsel. However, in February 2009, Mr. Drennan had sent a copy of the CGF offering memorandum to Instinet.

Thus, the payment to Ms. Mausner in June 2009 fell within the disclosures provided to investors and the SEC, and both HR and Instinet confirmed this to JSO before the payment was made.

**D. Office Rent**

The Staff takes issue with the use of soft dollars to pay for JSO's office rent. JSO's office is located in what had previously been Mr. Mausner's home. The house includes a room set up for presentations to JSO clients as well as a reception area to entertain clients. Rent was paid to J.O. Samantha, LLC, the owner of the home, in which Mr. Mausner was a part owner with Ms. Mausner for a time, and subsequently the sole owner. The rental payment was used to pay the mortgage, and any remainder was used for repairs, depreciation and related expenses. Since the house has become JSO's office, Mr. Mausner has used only one room for limited personal purposes. In fact, Mr. Mausner rented a home for his personal use using personal funds.

JSO consulted HR when considering soft dollar treatment of the rent payments. HR attorneys advised that soft dollars could be used for such payments. As advised by HR, the amount of rent was determined by estimation of market rental value. HR directed JSO to do market research with regard to rental value, which JSO did. HR advised that rent should be related to the market, though somewhat under or over the comparables would be acceptable. HR advised that the amount left after paying the mortgage could be used as Mr. Mausner saw fit. HR advised that the disclosures, which HR had drafted, were sufficient to cover this. The actual amount of rent used was discussed with and approved by HR, and any time the rent was increased, it was discussed with HR and approved before the increase was implemented. The rent was adjusted downward as well. Thus, JSO's soft dollar treatment of office rent was proper, pursuant to the advice of its counsel.

## IV. THE SOFT DOLLAR ACTIVITY DID NOT VIOLATE ANY OF THE ANTIFRAUD PROVISIONS OF THE SECURITIES ACT, EXCHANGE ACT, ADVISERS ACT OR RULES THEREUNDER

"Soft dollar arrangements are permissible under the securities laws if there is appropriate disclosure to the client about the products and services for which the soft dollars will be used, as well as disclosure that the client may pay a higher commission rate as the result of the soft dollar arrangement." *SEC v. Rollert*, SEC Litigation Release No. 18687 (D.Mass. Apr. 29, 2004).

As discussed above, all of the soft dollar activity in which JSO was engaged was fully disclosed to investors and the SEC. As to Fund investors, such activity was fully disclosed in the Offering Memoranda applicable to each Fund. As to the individual account investors, such activity was fully disclosed in the Form ADV provided as part of the IMA to investors and filed with the Commission.

Further, the soft dollar use was reasonable and fair to investors. No soft dollars were used to benefit Mr. Mausner personally. Moreover, Mr. Mausner received no personal benefit from the use of soft dollars because he received no distributions from JSO during the time period upon which the Commission appears to be focusing – late 2008 through 2010.

To be held liable under the anti-fraud provisions of the federal securities laws, JSO and Mr. Mausner must be found to have acted with scienter. *See Aaron v. SEC*, 446 U.S. 680, 695, 697 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). The Supreme Court has made clear that to establish a violation of section 10(b) of the

Exchange Act, Rule 10b-5, section 17(a)(1) of the Securities Act, and section 206(1) of the Advisers Act, the SEC must prove that the appellants acted with an "intent to deceive, manipulate, or defraud." *Hochfelder*, 425 U.S. at 194 n. 12; *Aaron*, 446 U.S. at 686 n. 5. Section 207 of the Advisers Act, concerning false statements in forms filed with the Commission, also has a scienter requirement of "willfulness." *SEC v. Slocum, Gordon & Co.*, 334 F.Supp.2d 144, 182 (D.R.I. 2004); 15 U.S.C. § 80b-7. Within the Ninth Circuit, the scienter element encompasses "deliberate recklessness." *S.E.C. v. Platforms Wireless Intern. Corp.*, 617 F.3d 1072, 1083 (9th Cir. 2010).

A company's scienter may be imputed from that of the individuals who control it. *In the Matter of Clarke T. Blizzard and Rudolph Abel*, Investment Advisers Act of 1940 Release No. 2253 (S.E.C. June 23, 2004), at *7 (citing *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1096-97 nn. 16-18 (2d Cir. 1992); *Kirk A. Knapp*, 50 S.E.C. 858, 860 n. 7 (1992). Thus, the question of scienter is the same for Mr. Mausner and JSO.

With regard to Mr. Mausner's scienter as an alleged aider and abettor of JSO's alleged violations of the Advisers Act, there is also a strict scienter requirement. In order to establish aiding and abetting liability, the Commission must demonstrate: (1) a primary or independent securities law violation by an independent violator; (2) the aider and abettor's *knowing and substantial assistance* to the primary securities law violator; and (3) *awareness or knowledge* by the aider and abettor that his role was part of an activity that was *improper. See SEC v. Fehn*, 97 F.3d 1276, 1288 (9th Cir.1996) (italics added). While it is unnecessary to show that an aider and abettor know he was participating in or contributing to a securities law violation, there must be sufficient evidence to establish "conscious involvement in impropriety." *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.1978). This involvement may be demonstrated by proof that the aider or abettor "had general awareness that his role was part of an overall activity that [was] improper." *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir.1974).

Neither Mr. Mausner nor, by extension, JSO could have acted with the requisite scienter with regard to the use of soft dollars. JSO and Mr. Mausner received extensive advice from counsel concerning JSO's soft dollar use, and they followed that advice.

In *In re Borgardt and Banhazl*, Initial Decision Release No. 167, Administrative proceeding File No. 3-9730 (2000), the four-part test for evaluating a reliance on counsel defense was stated. "Its essential elements are that a person: (1) made a complete disclosure to counsel of the intended action; (2) requested counsel's advice as to the legality of the intended action; (3) received counsel's advice that the conduct was legal; and (4) relied in good faith on that advice." *Id.* (citing cases from various circuits, including *SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 467 (9th Cir. 1985)). All of these elements are present here. The soft dollar activity in which JSO engaged was approved by its counsel after such counsel were fully informed of the nature of the activity and were provided with any information they requested. The disclosures regarding soft dollar activities, in the ADV and the Offering Memoranda, were drafted, reviewed and revised by counsel and as directed by counsel. Since its inception, JSO has paid hundreds of thousands of dollars for legal advice from top law firms, including the extensive involvement of highly experienced partners. The counsel that was consulted specialized in securities regulatory issues, particularly hedge fund issues. JSO, including Mr. Mausner himself, sought and received advice that the activities contemplated were lawful. JSO and Mr. Mausner relied in good faith on such advice. JSO took all of the steps it believed it should take to ensure regulatory compliance, and Mr. Mausner was personally involved in these efforts.

Accordingly, Mr. Mausner and JSO cannot be held liable under the antifraud provisions requiring scienter as Mr. Mausner reasonably relied in good faith on the advice of counsel and, at all times, acted with due care and concern for JSO's clients.

## V. TRADE ALLOCATION

The Staff takes issue with the allocation of trades during the period June 2008 to November 2009, among the Funds, the individual account of the Sapling Foundation ("Sapling") and "other accounts," which the Staff has so far refused to identify. The Staff's refusal to identify the other accounts involved prevents JSO and Mr. Mausner from providing a complete Wells Response. Our clients hereby renew their request that the Staff identify the other accounts at issue and provide our clients the opportunity to submit an additional Wells Response addressing the trade allocation allegations as to the other accounts. The following is submitted based upon the incomplete information so far provided by the Staff and addresses only allocation as to the Funds vis-à-vis Sapling.

Neither Mr. Mausner nor JSO has at any time fraudulently or unfairly allocated trades in favor of any of the Funds or any of the individual accounts to the detriment of any other Fund or individual account. With regard to allocation of trades between Sapling, on the one hand, and the Funds, on the other, the trading conducted on behalf of Sapling is not comparable to that conducted on behalf of the Funds. To begin with, each of these accounts had different objectives and dynamics at play, including different objectives and varying account sizes. Thus, there were trades that were simply not allocable to the Funds that were allocable to Sapling due to the volume of the trades, among other things. Accordingly, any analysis of the trades that treats them as allocable as between Sapling and the Funds would be invalid.

The substantial difference in strategy between Sapling and the Funds also indicates that many trades that were appropriate for Sapling were not appropriate for the Funds and vice-versa. Thus, such trades were not allocable as between Sapling and the Funds. Trades that are not allocable as between accounts cannot constitute a basis for a "cherry picking" allegation, as discussed in the case below.

In *SEC v. Slocum, Gordon & Co.*, 334 F.Supp.2d 144 (D.R.I. 2004), the Commission alleged that a registered investment advisory firm and its partners defrauded both their clients and the SEC through the practice of "cherry picking," whereby certain stocks were initially purchased for clients and later re-allocated to the firm account if the stocks went up in value prior to the settlement date. *Id.* at 148. Following a bench trial, the district court held that the Commission failed to prove the alleged cherry picking scheme by a preponderance of the evidence. *Id.* at 176. The Commission argued that the firm's method of operations, including the unlawful commingling of client and firm funds, the use of handwritten forms and the reliance upon manual controls created an environment in which fraud could have occurred. *Id.* at 171. The Commission further argued that the two-day window between execution of trades and settlement of trades, at which time blocks of securities could be allocated among firm and client accounts, provided an opportunity to allocate on the basis of the performance of the securities in the interim period, i.e., to cherry pick. *Id.* at 161-162. Moreover, the firm had not retained what it claimed were handwritten "scratch sheets" describing the proposed pre-trade allocation of block trades among clients and firm. *Id.* at 153-154. The district court rejected these arguments, holding that a "mere opportunity for possible fraud does not translate into actual wrongdoing." *Id.*

The Commission also presented what the court referred to as "circumstantial evidence" in the form of trading pattern analysis, which the Commission argued established an inference of cherry picking. *Id.* at 172. The Commission presented evidence showing that the firm realized a profit on securities purchased for its firm account 98% of the time and that this profit was always realized within the two-day window before settlement. *Id.* at 173. The securities purchased for the clients' accounts, on the other hand, decreased in value during the two-day period approximately 49% of the time. *Id.* The Commission argued that the disparity was evidence that the firm was allocating profitable trades within the two-day window to the firm and leaving the "pits" for the client accounts. *Id.* The court rejected this argument as well. *Id.* The court found persuasive the testimony of the firm's partners that they employed different strategies when trading for clients than they employed when trading for the firm's account. *Id.* The partners testified that they tried to purchase securities for their clients at a time of weakness and hold them for an extended period of time until they reached a position of strength. *Id.* For firm account trades, on the other hand, the partners testified that the firm looked for securities they hoped would suddenly increase due to market events. *Id.* The court found that this testimony adequately explained the Commission's statistical analysis as the result of different strategies, not fraudulent allocations. *Id.*

As in *Slocum*, the substantial difference in strategy (and size) between Sapling and the Funds accounts for any differences in their relative performance over the period at issue. As everyone knows, the markets during this period experienced losses of an almost unprecedented nature. As such, all of the Funds except for one suffered losses. The sole exception, CGF, was established in the summer of 2008 to take advantage of the emerging bear market. The CGF strategy was, thus, bearish, including put options and other investments not allocable to the other Funds or Sapling, which did not have bearish strategies.

In sum, Mr. Mausner and JSO have at all times fairly allocated trades between the Funds and Sapling.

## VI. <u>THE APPLICABLE STATUTES OF LIMITATIONS HAVE RUN ON A PORTION OF THE CLAIMS ANTICIPATED TO BE ASSERTED BY THE SEC</u>

SEC actions seeking civil penalties are subject to the five-year statute of limitations of 28 U.S.C. § 2462. *S.E.C. v. Berry*, 580 F.Supp.2d 911, 919 (N.D. Cal. 2008). The five-year limitations period begins to run "when the claim first accrued." 28 U.S.C. § 2462. The five-year statute is not subject to the discovery rule, but it is subject to equitable tolling. *Berry, supra*, at 919 (citing FEC v. Williams, 104 F. 3d 237, 241 (9th Cir. 1946). If the SEC can demonstrate that (1) the conduct at issue resulted in concealment of the operative facts; (2) the SEC failed to discover the operative facts within the limitations period; and (3) the SEC acted with due diligence before it discovered the conduct, the section 2462 statue of repose may be tolled. *Id.*

With regard to the Commission's allegations concerning misallocation of trades, there is no equitable tolling argument available to the SEC. There was no fraudulent concealment by Mr. Mausner or JSO. In any event, the performance of the Funds and the separate accounts was recorded in trading records, client statements and other records fully available to the SEC at any time. Accordingly, assuming *arguendo* that the Commission filed its prospective complaint on August 31,2013, any trading allocation prior to August 31, 2008 would be outside the statue.

## VII. CONCLUSION

In conclusion, we respectfully submit that the history pattern and the facts do not support the allegations. Ian Mausner has always set a tone of honesty, openness, compliance and integrity during his entire life and career including his tenure at JSO. To the extent there was ever anything not done completely properly it was either upon reliance on counsel or was entirely inadvertent. The issues in question were quickly corrected unilaterally by JSO very soon after being brought up further showing the firm's desire to be compliant.

We ask the Court to carefully examine the facts and the history and to find both Ian Mausner and JSO innocent of all allegations. Thank you for your time and consideration.