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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.

# THE DIVISION OF ENFORCEMENT'S POST-HEARING REPLY BRIEF

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## I. INTRODUCTION

In their post-hearing briefs, respondents J.S. Oliver Capital Management, L.P. ("J.S. Oliver"), Ian O. Mausner ("Mausner"), and Douglas F. Drennan ("Drennan") fail to present any valid defenses that are supported by the evidence. As described more fully below, the evidence instead establishes that Mausner and J.S. Oliver violated the federal securities laws by "cherry-picking" favorable stock trades for their benefit and to the detriment of clients, and by the misuse of "soft dollar" client commission credits. The evidence also establishes that Drennan aided, abetted, and caused J.S. Oliver's and Mausner's soft dollar abuses.

Cherry-Picking

Mausner's arguments against the cherry-picking violations are nonsensical and contrary to all of the evidence in the case. Mausner argues, for example, that cherry-picking could not have occurred because the disfavored accounts, which were harmed by Mausner's cherry-picking, "did essentially the same as" or "did even better than" the favored accounts. (Mausner Posthearing Brief ("Mausner Br."), pp. 18-19.) But that's not true. The Division's cherry-picking expert, Paul Glasserman, a Professor of Business at Columbia Business School, conducted a rigorous review of all equity trades by J.S. Oliver over a nearly three-year period and found disproportionate allocations between favored and disfavored accounts that could only have been caused by biased allocations, or cherry-picking, by Mausner. Professor Glasserman also found that the disfavored accounts suffered dramatic first-day losses, while the favored accounts experienced positive first-day returns. Professor Glasserman's findings are consistent with the experience of Christopher Anderson, whose disfavored Sapling Foundation ("Sapling") account performed much worse than the overall market at the same time Mausner was touting that J.S. Oliver's Concentrated Growth Fund ("CGF") was outperforming the market.

Mausner failed to offer anything to refute this well-founded analysis of his cherry-picking. In fact, the only evidence he cites in support of his claim that the disfavored accounts performed just as well or even better than the favored accounts are three documents – two internet printouts and an email prepared in advance of the hearing by his co-respondent, Drennan, at Mausner's request. Neither support his defense, and in fact they rebut his defense. For example, although Mausner argues that one of the printouts shows that the Sapling account saw a positive return in 2009, it actually shows that Sapling lost more than $3 million in 2009. The other printout and the Drennan email are similarly unavailing.

Mausner's other attacks on the Division's expert's report and testimony also fail. He argues that Professor Glasserman "only examined selected trades," and that he did not determine whether Mausner's biased trade allocations caused any harm. Again, none of what he says is supported by the evidence. Rather, the evidence is clear that Professor Glasserman reviewed all of the equity transactions that appeared in J.S. Oliver's blotter from January 1, 2007 to November 30, 2009. The evidence is also clear that Mausner's cherry-picking scheme caused harm to the disfavored accounts. Professor Glasserman found that they were harmed $10.9 million as a result. Mausner's attacks against the compelling evidence of cherry-picking should be rejected.

Soft Dollar Abuses

Respondents' arguments against the evidence of their soft dollar misuses are also belied by the evidence. Respondents' principal argument is that they relied on J.S. Oliver's counsel or, alternatively, on Instinet LLC's ("Instinet") counsel, to provide advice that respondents' uses of soft dollars were legal. But this purported advice-of-counsel defense suffers from several fatal flaws. Foremost, in order to claim reliance on counsel a respondent has the burden to show, among other things, that he made complete disclosure to counsel of all material information, that

he received advice that the proposed action was legal, and that he relied in good faith on the advice. An advice of counsel claim fails if any of these elements is not proven. Even if advice of counsel is proven, it is not an absolute defense, but only one factor to be considered in determining liability.

There is absolutely no evidence here that respondents made complete disclosures to counsel of all material information regarding their planned uses of soft dollars. For example, there is no evidence that respondents disclosed to counsel (or to Instinet) that they intended to reimburse with client soft dollars Mausner's divorce settlement payment "in lieu of spousal support" to his ex-wife, Gina Kloes, even though she had not worked for J.S. Oliver for several years. They also never disclosed to counsel that they planned to use a fabricated contract "excerpt" to support respondents' soft dollar invoice for the payment to Ms. Kloes. Similarly, there is no evidence that respondents disclosed to counsel that they planned to use soft dollars to pay inflated "rent" to Mausner, or that Mausner would funnel hundreds of thousands of dollars of excess "rent" to his personal bank account. Nor is there any evidence that Mausner disclosed to counsel that he was going to use client soft dollars to pay expenses on his personal timeshare at the St. Regis luxury hotel in New York City, which he used regularly for uses that did not benefit J.S. Oliver's clients, such as meeting with prospective new clients, visiting relatives, and trips with girlfriends. Finally, there is no evidence that respondents disclosed to counsel that they planned to use client soft dollars to pay Drennan's purported consulting salary and six-figure bonus under the guise of the Section 28(e) safe harbor even though Drennan really functioned as a full-time J.S. Oliver employee who performed a wide variety of non-research duties, including setting up J.S. Oliver's soft dollar program with Instinet. Indeed, in most instances, neither Mausner nor Drennan could even recall any specific conversations with counsel regarding their planned soft dollar uses. Because respondents did not disclose all material facts to counsel, did

not present any credible evidence of advice received, and thus could not have relied in good faith on any advice from counsel, their claim of reliance on counsel should be rejected.

Respondents assert several other defenses, none of which have any merit. Respondents, for example, try to employ tortured readings of J.S. Oliver's offering memoranda to argue that their soft dollar uses actually were disclosed to clients. But a plain reading of the soft dollar disclosure language in the offering memoranda refutes respondents' argument. No reasonable client, for example, would understand J.S. Oliver's offering materials to disclose as possible uses of client soft dollars Mausner's payment to his ex-wife pursuant to a divorce settlement, or payments of inflated rent with hundreds of thousands of dollars in excess funds being siphoned off to Mausner, or payments of expenses for Mausner's personal timeshare. Nor would a reasonable client understand the offering materials to permit the payment of salary and a six-figure bonus to Drennan under the Section 28(e) safe harbor when he was functioning as a J.S. Oliver employee.[1]

Respondents also argue other positions that are flatly refuted by the evidence, for example that Ms. Kloes continued to work at J.S. Oliver and that her payment constituted salary (Mausner Br., pp. 32-33), or that Drennan's responsibilities were "almost entirely research related." (Drennan Posthearing Brief ("Drennan Br."), p. 42.) Both positions are shown by the evidence to be wrong.

Drennan also disputes the evidence of his scienter, and argues that actual knowledge is required for aiding and abetting liability. On the contrary, the Commission applies a

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[1] The CGF offering memorandum disclosed "salaries, benefits and other compensation of employees or of consultants" as possible uses of client soft dollars. But J.S. Oliver also earned soft dollar credits through the trades of individual clients and the J.S. Partners Funds, and the individual clients and J.S. Partners Funds investors did not receive the CGF offering memorandum. (Trial Tr. (Mausner) 1236:18-1237:8; 1267:14-19.)

"recklessness" standard for aiding and abetting liability in administrative proceedings where, as here, the aider and abettor is associated with an investment adviser, and only negligence is required for "causing" liability. *See In the Matter of Daniel Bogar, et al.*, Initial Decisions Rel. No. 502, 2013 SEC Lexis 2235 at *63-66 (Aug. 2, 2013); *In the Matter of Robert M. Fuller*, Exchange Act Rel. No. 48406, 2003 SEC Lexis 2041 at *21, n.29 (Aug. 25, 2003) (negligence standard applies for "causing" liability). Regardless, Drennan's conduct, established by an abundance of evidence presented at the hearing, more than satisfies an actual knowledge standard.[2]

Finally, respondents resort to specious arguments regarding, for example, the appropriate market rate determination for rent on Mausner's house, or whether the Mausner's divorce settlement called the monies owed to Ms. Kloes "salary," regardless of whether or not she performed any services for J.S. Oliver. But these arguments miss the point completely. The bottom line is whether J.S. Oliver's soft dollar disclosures were made to clients with such specificity so that the clients could understand what supposed benefit was being obtained with their soft dollars. That kind of disclosure is required because the use of soft dollars is otherwise an undisclosed use of clients' assets – a conflict of interest – and, if not adequately disclosed is a breach of fiduciary duty when it puts the adviser's interest ahead of its clients. Respondents breached that duty here. No reasonable client would interpret J.S. Oliver's soft dollar disclosures to permit the payment of a $329,365 lump-sum divorce settlement payment, "in lieu of spousal support," to Mausner's ex-wife, who had not performed any services for J.S. Oliver for years. No reasonable client would interpret J.S. Oliver's soft dollar disclosures to permit the payment of

[2] Drennan also claims, wrongly, that the Division "devotes merely two pages" to outlining the evidence of Drennan's liability. While the Division summarizes the evidence against Drennan near the end of its initial brief, the body of the brief is replete with discussions regarding and citations to evidence of Drennan's liability. *See, e.g.*, Division's Initial Brief at pp. 4-5, 19-21, 23, 28-34, 36-39, 49, 60-62.

inflated rent on Mausner's house, with Mausner pocketing hundreds of thousands of dollars in excessive payments. No reasonable client would interpret J.S. Oliver's soft dollar disclosures to permit the payment of expenses on Mausner's personal timeshare at the St. Regis luxury hotel in New York City. And no reasonable client would interpret J.S. Oliver's soft dollar disclosures to permit the payment of salary or a six-figure bonus to Drennan. And, in fact, three of J.S. Oliver's former investors testified at the hearing on this matter that such uses would be "unethical" and "horrifying" and that each would have thought differently about investing their money with J.S. Oliver and Mausner had they known about such soft dollar uses. (*See*, *e.g.*, Trial Tr. (Anderson) 72:2-22; Trial Tr. (Hall) 794:6-25; Trial Tr. (Mahler) 824:1-10.)

## II. ARGUMENT

### A. Mausner's And J.S. Oliver's Arguments Against the Evidence of Cherry-Picking Are Without Merit

The evidence presented by the Division established that, from June 2008 to November 2009, Mausner and J.S. Oliver engaged in a fraudulent "cherry-picking" scheme, in which Mausner disproportionately allocated profitable trades to six accounts including J.S. Oliver's affiliated hedge funds, and disproportionately allocated unprofitable trades to three clients' accounts, including the Sapling charitable foundation account and a 78-year-old widow. Mausner and J.S. Oliver were able to cherry-pick favorable trades because Mausner could wait to allocate trades to specific accounts until long after the trades were made, and in many instances until after the close of trading or the following day. By waiting to allocate the trades, Mausner knew which trades had been profitable and which had been unprofitable from the time they were executed until the time of allocation. Notably, Mausner and J.S. Oliver do not challenge any of the evidence that Mausner had the ability to wait to allocate trades until he knew which trades had been profitable and which had been unprofitable.

The Division's cherry-picking expert, Professor Glasserman, presented a thorough statistical analysis that concluded that the only explanation for the observed disproportionate allocations was a deliberate effort by Mausner to cherry-pick trades. (Div. Exh. 695a.) Professor Glasserman, using basic and generally-accepted statistical methods, showed that the likelihood that the observed difference in allocation between profitable and unprofitable trades to the favored and disfavored accounts occurred by chance was approximately 1 in one quadrillion ($10^{15}$), and that the extreme bias in trade allocations was due to cherry-picking by Mausner and J.S. Oliver, ruling out any possibility that the differences in performance were due to chance fluctuations. (*See, e.g.*, Trial Tr. (Glasserman) 124:4-17.) Professor Glasserman's unrebutted analysis was corroborated by the testimony of one of J.S. Oliver's clients, Christopher Anderson, who performed an analysis of his charitable foundation's account and testified that the most actively traded stocks significantly underperformed in the Sapling account, which caused Mr. Anderson to terminate his relationship with J.S. Oliver.

Mausner attacks the Division's cherry-picking evidence on two grounds, neither of which has any merit. First, Mausner tries to use two documents that he printed from a website and another document created by his co-respondent Drennan to argue that Mausner's hedge funds performed similarly to the disfavored accounts. (Mausner Br. pp. 18-21.) But the documents to which Mausner cites are of questionable, if any, evidentiary value, and do not support Mausner's assertions even if they are accurate. Moreover, the conclusions that Mausner seeks to draw from these documents are refuted unequivocally by the Division's evidence. Second, Mausner challenges the written report and testimony of Professor Glasserman by arguing incorrectly that his analysis "only examined selected trades" and that he did not determine whether Mausner's cherry-picking "caused any harm." (Mausner Br., pp. 22, 24.) Mausner's arguments completely ignore Professor Glasserman's thorough and detailed analysis, in which he analyzed every equity

trade made by J.S. Oliver from January 2007 through November 2009, and calculated that Mausner's cherry-picking caused $10.9 million in harm to the disfavored accounts. Mausner's arguments are not supported by the evidence and should be rejected.

### 1. The website printouts and email that Mausner's uses to contest the Division's cherry-picking evidence are unreliable and were discredited by Drennan's and Mausner's own testimony

Mausner tries to counter the strong evidence of cherry-picking against him by claiming, falsely, that the disfavored accounts performed as well as or better than the favored accounts. As an initial matter, the documents upon which Mausner relies to try to make this assertion are of dubious, if any, evidentiary value. Mausner's Exhibits C and D constitute printouts from a website with no testimony regarding the source of the information and calculations contained on the website, the identity of the person who allegedly prepared the data or made the calculations set forth on the website, the manner in which the documents were prepared, or what the documents purportedly represent.

But most importantly, the data set forth in Exhibits C and D, by Drennan's and Mausner's own admissions, is flawed and does not support Mausner's interpretations of the account performances. For example, Drennan, through whom Mausner introduced Exhibits C and D, testified that some of the calculations reflected in Exhibits C and D appeared to be wrong. After being directed to inconsistencies in Mausner's Exhibit D, Drennan testified: "One of the numbers seems to be wrong ... I can't reconcile a positive return versus a negative total gain/loss. It doesn't make sense." (Trial Tr. (Drennan) 1179:2-12.) Indeed, Mausner admitted that, contrary to his desired interpretation of Exhibit D, which he hoped would show that the Sapling account had enjoyed a positive return in 2009, the Sapling account did, in fact, suffer losses of

more than $3 million in 2009.[3] (Trial Tr. (Mausner) 1344:24-1347:18.) In fact, if we take a closer look at the printouts, Exhibits C and D show the following:

| Account | Beginning Equity | Withdrawal by Account Holder | Total Annual Realized & Unrealized Gain (Loss) | Annual Percentage Loss[4] |
|---|---|---|---|---|
| Sapling | 2008:<br>$30,928,885.56<br>2009:<br>$15,192,855.42 | 2009:<br>$(12,052,966.14) | 2008:<br>$(14,694,542.53)<br>2009:<br>$(3,206,955.35) | 2008:<br>47.5%<br>2009:<br>n/a |
| Chelsey | 2008:<br>$11,851,090.26<br>2009:<br>not provided | | 2008:<br>$(5,295,675.77)<br>2009:<br>not provided | 2008:<br>44.7%<br>2009:<br>n/a |
| J.S. Oliver Investment Partners II | 2008:<br>$24,461,996.30<br>2009:<br>$5,014,118.90 | | 2008:<br>$(7,029,222.52)<br>2009:<br>$(1,677,016.85) | 2008:<br>28.7%<br>2009:<br>33.4% |
| J.S. Oliver Offshore Partners LP | 2008:<br>not provided<br>2009:<br>$1,980,344.92 | | 2008:<br>not provided<br>2009:<br>$(98,389.91) | 2008:<br>n/a<br>2009:<br>5.0% |
| J.S. Oliver Concentrated Growth Fund | 2008:<br>not provided<br>2009:<br>$8,181,479.85 | | 2008:<br>not provided<br>2009:<br>$(1,514,184.87) | 2008:<br>n/a<br>2009:<br>18.5% |

Thus, analyzing these numbers, Exhibit C clearly shows that while J.S. Oliver Investment Partners II ("Fund II") had a 28.7% loss in 2008, Sapling and Chelsey suffered losses of 47.5%

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[3] Mausner's attempts to attribute the artificially poor performance of the disfavored accounts to a downturn in the overall market is thoroughly disproven by the evidence. For example, Mausner, in correspondence with Mr. Anderson in mid-2009, confirmed that the Sapling account was down 9.46% year-to-date, while the benchmark indices were up approximately 8%, a spread of more than 17%. (Div. Exh. 12; Trial Tr. (Anderson) 52:16-53:14.) Mausner also confirmed that his hedge fund had outperformed the market during that time. (Div. Exh. 15.) At the time, Mausner blamed the "entire difference" on his inability to trade options in the Sapling account. (*Id.*) The Division's cherry-picking expert, Professor Glasserman, showed that options trading was irrelevant to the conclusion that Mausner had engaged in cherry-picking. (Div. Exh. 695a, ¶ 18.)

[4] The Division performed a straight calculation here, dividing the total annual realized and unrealized loss by the beginning equity to arrive at the percentage loss each year.

and 44.7%, respectively, in that same year (an almost 19% and 16% difference for Sapling and Chelsey, respectively, compared to Fund II; clearly, a material difference). Notably, Mausner failed to introduce a similar chart with the purported results of CGF in 2008, which must have performed positively, otherwise Mausner would not have paid himself 20% in performance fees ($224,600). (Div. Ex. 189.) Analyzing the numbers from Exhibit D, while the 2009 losses were 33.4% for Fund II, 5.0% for Offshore, and 18.5% for CGF, Mausner has provided no data from the other accounts to compare. In 2009, Sapling had losses of over $3 million and withdrew the other $12 million from the account before year-end, so it is difficult to analyze the numbers from Exhibit D on a level playing field. No other purported account printouts were introduced by Mausner at the hearing in this proceeding.[5]

In short, neither of these website printouts supports Mausner's contention that the favored and disfavored accounts "did essentially the same" or that the disfavored accounts "did even better." Indeed, all evidence supports the opposite conclusion: the favored accounts profited greatly at the expense of the disfavored accounts.

Moreover, the evidence presented by Professor Glasserman further refutes Mausner's strained interpretation of his website printouts. Professor Glasserman's rigorous analysis of the J.S. Oliver trade data establishes that, from at least June 2008 through November 2009, the first-day returns of the favored accounts far outperformed the returns of the disfavored accounts.[6] In fact, the evidence shows that, during the relevant period, the disfavored accounts suffered first-

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[5] Curiously, Mausner did not introduce a similar chart for the third disfavored account discussed at the hearing. Mausner also did not provide 2009 numbers for Chelsey, so the Division is unsure where he got the percentage discussed in his brief. (Mausner Br., p. 19).

[6] As Professor Glasserman explained, the first-day return is the appropriate measure for the cherry-picking analysis because Mausner was able to delay his allocations of block trades to individual accounts until after he determined which securities had appreciated and which had declined in value after the execution of the trades, and allocated them accordingly. (Div. Exh. 695a, at ¶ 17.)

day losses of greater than 1% (equaling losses of greater than 90% on an annualized basis), while the favored accounts enjoyed positive first-day returns. (Div. Exh. 695a, ¶¶ 32-33, 43-45, and Exhs. 3, 8 thereto.)

Finally, Mausner cites to Exhibit B, which is an email containing a chart that he apparently had his co-respondent Drennan prepare shortly before the hearing in this proceeding. (Trial Tr. (Drennan) 1030:6-8.) As with Mausner's website printouts, there was no testimony regarding the source of the data used to create Exhibit B, the circumstances regarding its creation, or the methodology used to generate the data contained therein. In addition to the self-serving nature of Exhibit B, it is unclear what Drennan's email purports to show. Mausner apparently is under the mistaken assumption that the Division contends that the differences in performance between the favored and disfavored accounts was solely due to day trading. (*See* Mausner Br., p. 21.) Not so. The Division contends that the first-day returns of the favored accounts were vastly different from the first-day returns (or losses) suffered by the disfavored accounts, not that day trading accounted for all of the difference. The key factor in the cherry-picking analysis is whether Mausner allocated trades inequitably after he had learned whether or not they were profitable, not whether he sold a security the same day that he bought it. Indeed, Professor Glasserman's report controls for, among other things, a buy-and-hold strategy by analyzing a subset of securities that were held for ten days or more, and finds that the evidence of cherry-picking is even stronger in the buy-and-hold context than in the case of all equity trades. (Div. Exh. 695a, ¶¶ 57-59 and Exh. 11 thereto.) For these reasons, Mausner's Exhibit B, even if the data contained therein were reliable, which it is not, is irrelevant to determination that Mausner engaged in cherry-picking.

### 2. Mausner's assertions that the Division's cherry-picking expert only examined selected trades, or did not determine whether Mausner's cherry-picking caused any harm, are belied by the evidence

Mausner challenges the factual findings of Professor Glasserman based on the erroneous proposition that Professor Glasserman's analysis "only highlighted some of the losing trades" or "only examined selected trades." (Mausner Br., pp. 22, 24.) On the contrary, Professor Glasserman's analysis involved a comprehensive review of "all equity transactions that appear[ed] in the J.S. Oliver trade blotter from January 1, 2007 to November 30, 2009," which included more than 39,000 allocations of block trades during the period of Mausner's cherry-picking as well as the preceding 17 months. (Div. Exh. 695a, ¶ 23.) Professor Glasserman summarized the results of this analysis in his report, finding unequivocal evidence that Mausner engaged in cherry-picking, allocating profitable trades disproportionately to the favored accounts and unprofitable trades disproportionately to the disfavored accounts. (*See* Div. Exh. 695a, ¶¶ 23-37, Exhs. 1-5 thereto.) Professor Glasserman also examined several narrower subsets of data to control for potential explanations of the differences in performance, including analyses of "same day, same security" transactions; stocks traded only by the disfavored accounts; controlling for "short-oriented strategies" by excluding CGF and short sales; stocks that were held for at least ten days; and trades that were executed on highly volatile market days. (*Id.*, ¶¶ 38-61.) In every instance, Professor Glasserman's analysis showed conclusively that the difference in performance between the favored and disfavored accounts was the result of cherry-picking by Mausner and J.S. Oliver.

Finally, Mausner asserts that Professor Glasserman's analysis did not address whether Mausner's biased allocation of trades "caused any harm." (Mausner Br., p. 22.) Again, Professor Glasserman's analysis is clear on this issue. Professor Glasserman computed the impact of Mausner's cherry-picking by calculating the returns that the favored and disfavored

accounts would have received in the absence of cherry-picking. (Div. Exh. 695a, ¶ 62.) Professor Glasserman found that Mausner's cherry-picking scheme caused harm of $10.9 million to the disfavored accounts. (*Id.*, ¶ 62 and Exh. 13 thereto.) The cherry-picking correspondingly benefited Mausner, who had invested in CGF and who received performance fees based upon the inflated performance of the hedge funds, particularly CGF.

### B. Respondents' Arguments Against Liability for Soft Dollar Abuses Are Not Supported By the Evidence

The evidence at the hearing established that Mausner and J.S. Oliver, aided, abetted, and caused by Drennan, misused client assets in the form of soft dollar credits for (1) reimbursement of a payment to Mausner's ex-wife pursuant to a divorce agreement; (2) payment of inflated "rent" to Mausner, with tens of thousands of excessive rent payments being funneled to Mausner's personal bank account; (3) Mausner's personal timeshare payments;[7] and (4) payments of salary and bonuses to Drennan. (*See* Division's Initial Brief, pp. 23-39.) None of these uses of client soft dollars was disclosed to J.S. Oliver's clients, who testified that they would have considered such uses "horrifying" (Trial Tr. (Anderson) 72:2-15), "unethical" (Trial Tr. (Hall) 794:6-25), and inconsistent with personal ethics (Trial Tr. (Mahler) 824:1-10) had they known about them.

#### 1. Respondents' misuses of client soft dollars were not approved by counsel

Respondents argue that their uses of soft dollars were all properly disclosed to J.S. Oliver's clients and were approved by J.S. Oliver's counsel and, in the case of the payment to Mausner's ex-wife, impliedly approved by Instinet through its processing of the soft dollar

[7] The Division does not allege that Drennan aided, abetted, and caused J.S. Oliver's and Mausner's violations relating to the timeshare payments.

invoice. Respondents' assertions, however, are directly contradicted by the evidence presented by the Division at the hearing in this proceeding.

In their post-hearing briefs, respondents claim that all of their soft dollar activities were approved by counsel. The evidence contradicts these claims. In order to claim reliance on counsel, a respondent must show that he (1) made a complete disclosure to counsel of all material information, (2) requested counsel's advice as to the legality of the contemplated action, (3) received advice that his conduct was legal, and (4) relied in good faith on that advice. *SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 467 (9th Cir. 1985). The burden is on the respondent to establish each element of a reliance on counsel defense, and the claim fails where any of these elements are not proven. *Id.; see SEC v. AIC, Inc.*, 2013 U.S. Dist. Lexis 130249 at *22 (E.D. Tenn. Sept. 12, 2013) Indeed, "[n]umerous courts specifically have held that a claim of 'good faith' or reliance on professionals is not available when a defendant has withheld material information from the professionals." *SEC v. Yuen*, 2006 U.S. Dist. Lexis 33938 at *113 (C.D. Cal. March 16, 2006); *see also SEC v. Scott*, 565 F. Supp. 1513, 1534 (S.D.N.Y. 1983) (no good faith reliance where defendant failed to inform counsel of all material facts); *SEC v. Enterprises Solutions, Inc.*, 142 F. Supp. 2d 561, 576 (S.D.N.Y. 2001) ("Good faith reliance on the advice of counsel means more than simply supplying counsel with information. Corporate executives have an independent duty to insure that proper disclosures are made"). Moreover, "while good faith reliance on advice of counsel by a criminal defendant may rebut evidence of criminal intent, in the context of a securities action, reliance on counsel is not a complete defense, but only one factor for consideration" in determining liability *AIC, Inc.*, 2013 U.S. Dist. Lexis 130249 at *22. Here, the evidence is clear that respondents did not make complete disclosures to counsel of all

material information regarding their planned uses of soft dollars, did not request counsel's advice or receive advice that their intended uses of soft dollars were legal, and did not act in good faith.[8]

In addition, respondents cite no legal authority for the proposition that Instinet's processing of their soft dollar invoices negates respondents' scienter. Particularly in the context of an investment adviser's fiduciary duties to its clients under the federal securities laws, that duty would be rendered meaningless if an investment adviser could pass off its fiduciary duties to a third party. But even if reliance on Instinet's counsel were a viable argument, the evidence shows that respondents did not disclose all material facts either to their counsel or to Instinet, and thus cannot rely on Instinet's acceptance to process the soft dollar payments as a defense to respondents' soft dollar violations.

**a) Reimbursement of Mausner's divorce settlement payment**

**i. Respondents' use of soft dollars to reimburse Mausner for payments made pursuant to his divorce settlement were not disclosed to J.S. Oliver's clients or to the Funds' investors**

In his post-hearing brief, Mausner continues to argue that the reimbursement of his divorce settlement payment to Ms. Kloes was a proper use of client soft dollars. (*See* Mausner Br., p. 30.) Such a position, however, is rebutted by all of the credible evidence that was presented at the hearing on this action. The evidence showed that Mausner and J.S. Oliver never disclosed to their clients that they would use client soft dollar credits to pay Mausner's ex-wife pursuant to a divorce agreement funds "in lieu of spousal support," and such payments were not in the best interest of J.S. Oliver's clients. None of J.S. Oliver's disclosures addressed such use

[8] Mausner's apparent assertion that respondents should be absolved of liability because counsel prepared J.S. Oliver's Forms ADV and offering memoranda is unavailing. (Mausner Br., pp. 27-28.) "Compliance with federal securities laws cannot be avoided by simply retaining outside counsel to prepare required documents." *SEC v. Enterprises Solutions, Inc.*, 142 F. Supp. 2d at 576.

of soft dollars. The payment to Ms. Kloes was neither salary nor a consulting fee, because Ms. Kloes was not obligated to do any work for the firm in exchange for the payment and, the evidence showed, Ms. Kloes did not perform any work after 2007.

Respondents' refusal to admit that Ms. Kloes ceased her role as a J.S. Oliver employee long before the 2009 divorce payment is contradicted throughout the record in this action, including by Ms. Kloes and by Mausner himself. The Mausners' 2005 divorce agreement required Ms. Kloes to perform limited work for J.S. Oliver in 2005 and 2006, with no obligation for her to perform any work from 2007 on. (Trial Tr. (Kloes) 491:2-11; Div. Exh. 22 at GMM 1053-54.) Ms. Kloes testified that she could not recall doing any work for J.S. Oliver in 2007, and that she did not do any such work in 2008 or beyond. (Trial Tr. (Kloes) 494:23-495:2; 505:11-24; 505:25-506:2.) Ms. Kloes also testified that, although her 2005 divorce settlement agreement with Mausner required Mausner to pay her "through the firm," she "wasn't an employee there." (Trial Tr. (Kloes) 502:11-503:6; 512:20-513:7.) Melanie Kartes, who worked as the controller at J.S. Oliver from 2008 through 2011, testified that during the entire time she worked at J.S. Oliver, she never had any telephone calls or meetings with Ms. Kloes and Ms. Kloes never came to J.S. Oliver's office. (Trial Tr. (Kartes) 565:18-566:13; 617:4-19.) Mausner himself did not consider Ms. Kloes to be an employee of J.S. Oliver after 2005. Mausner turned off Ms. Kloes' email address at J.S. Oliver in 2005 when Ms. Kloes was terminated as CFO. (Trial Tr. (Kloes) 483:23-484:11.) In November 2005, Mausner wrote to Ms. Kloes, "Since you are no longer with JSO, could you stop using the firm email or any other firm stuff." (Div. Exh. 24 at GMM 1509; Trial Tr. (Kloes) 484:12-485:21; Trial Tr. (Mausner) 1285:9-1286:7.) Mausner instructed one J.S. Oliver employee in 2008 that "Gina's not allowed anywhere in here. You're not allowed to talk to her. She's not allowed to be anywhere near the place." (Trial Tr. (Kloes) 505:11-24.) Ms. Kloes also testified at the hearing about the 2008 restraining order she

had against Mausner, which was corroborated by Mausner and the 2009 divorce agreement. (Trial Tr. (Mausner) 1293:2-9; Trial Tr. (Kloes) 505:6-7; Div. Ex. 26, Section XI.) Mausner also testified previously under oath that Ms. Kloes stopped working for J.S. Oliver in 2005. In a 2010 deposition in an action brought by former client Chris Anderson, Mausner testified that Ms. Kloes stopped working for J.S. Oliver "somewhere around, you know, when we got divorced, so it would have been in 2005." (Trial Tr. (Mausner) 1288:24-1290:20.)

Moreover, even if the facts were different and the divorce payment to Ms. Kloes could be considered "salary," the Forms ADV, Part II, which were received by J.S. Oliver's individual clients, and the offering memoranda for J.S. Oliver Investment Partners I, L.P. ("Fund I"), Fund II, and J.S. Oliver Offshore Investments Ltd. (collectively, the "J.S. Partners Funds"), which were received by investors in the J.S. Partners Funds, did not disclose that client soft dollar credits could be used for any salaries. Only the CGF offering memorandum disclosed salary as a potential use of soft dollars, and that disclosure nowhere indicated that such "salary" could be paid in an excessive amount pursuant to a divorce agreement to an individual performing no work for the firm.

**ii. Respondents' cannot satisfy their burden of proving reliance on counsel, or "reliance on Instinet" regarding the reimbursement of Mausner's divorce settlement payment**

Contrary to their arguments, respondents never made complete disclosure to counsel or to Instinet regarding the use of client soft dollar credits to pay Mausner's divorce settlement with his ex-wife. Instead, Mausner and Drennan repeatedly misrepresented and withheld key information from their attorneys and from Instinet and fabricated a document in their efforts to cause Instinet to reimburse the divorce settlement payment to Ms. Kloes with soft dollars. Mausner and Drennan did everything they could to hide the fact that the payment to Ms. Kloes

was made "in lieu of spousal support," and instead withheld that material information from and lied to Instinet, and never disclosed such material facts to J.S. Oliver's counsel.

As of mid-2009, Drennan had been working at J.S. Oliver's offices daily since 2004, except for a six-month hiatus in 2008. He therefore knew that Ms. Kloes was not acting as a consultant of any type, and certainly knew that Ms. Kloes never appeared at J.S. Oliver's offices after 2007, at the latest. (Trial Tr. (Kartes) 565:18-566:13; 617:4-19.) In addition, Drennan had a copy of the Mausners' 2005 marital settlement agreement ("MSA"), which provided that Ms. Kloes had no obligation to perform any work at all after 2006. (Trial Tr. (Drennan) 1003:23-1004:7; Div. Exh. 342; Div. Exh. 22 at pp. 8-9.) Nevertheless, on May 8, 2009 Drennan, at Mausner's request, contacted an Instinet employee, Jonathan Ranello, regarding reimbursement of the payment to Ms. Kloes, and falsely represented to Mr. Ranello that the reason for the payment was that J.S. Oliver intended to keep Ms. Kloes on Instinet's payroll as a consultant for tax or compliance-related issues. (Trial Tr. (Drennan) 987:8-18; Trial Tr. (Mausner) 1281:23-1282:7; Div. Exhs. 1313, 1314.)

Drennan again lied regarding the employment status of Ms. Kloes in an email to be forwarded to Instinet that he drafted, again at Mausner's request, on May 26, 2009. (Trial Tr. (Drennan) 1006:9-16; 1007:14-18; Div. Exhs. 344, 545.) In that email, Drennan falsely represented that Ms. Kloes "has remained an employee of J.S. Oliver offering advice on organizational and accounting issues" and that "Gina and J.S. Oliver have an agreement" to pay Ms. Kloes a salary through 2011, and that J.S. Oliver planned to pay the salary due to Ms. Kloes in a "lump sum." (Div. Exhs. 344, 545.) Drennan made these false statements to Instinet even though he admitted that he "did not have any experience with her then doing advice on organizational and accounting issues." (Trial Tr. (Drennan) 1008:25-1010:2.) In fact, Drennan admitted that he knew that Ms. Kloes was not a J.S. Oliver employee when he left J.S. Oliver in

mid-2008 and that she was not an employee when he returned in 2009. (Trial Tr. (Drennan) 894:21-895:6.) Drennan never told Instinet that the information in the email he had drafted was false. (Trial Tr. (Drennan) 1010:23-25.) Mausner sent this false email to Instinet on May 26, and Drennan forwarded it to his direct Instinet contact, Neil Driscoll, a few minutes later. (Div. Ex. 545.)

Following Instinet's receipt of the May 26 email from Mausner and Drennan, Mr. Driscoll called Drennan to request an in-person meeting with Mausner to obtain additional information regarding the reimbursement request. During the meeting, Instinet's representatives requested a copy of the agreement between J.S. Oliver and Ms. Kloes that purportedly required the lump-sum salary payment. (Trial Tr. (Driscoll) 298:7-12; Div. Exh. 70.) This time, Drennan and Mausner concocted a scheme to fabricate a document for presentation to Instinet. At Mausner's direction, Drennan (1) cut and pasted portions of the Mausners' 2005 MSA into an email; (2) had the pasted language converted into PDF format and placed on J.S. Oliver letterhead, so that it could be forwarded to Instinet; (3) drafted additional language that represented that the "excerpt" was from a contract between Ms. Kloes and Mausner, but then altered the language to represent falsely that it was "from the contract between J.S. Oliver Capital Management, L.P. and Gina Mausner"; (4) deleted from the "excerpt" references that were clearly personal in nature, including references to country club memberships, a nanny, a weekly housekeeper, and Ms. Kloes' part-time assistant; and (5) knew that Mausner intended to forward the fabricated language to Instinet as evidence to support respondents' claim that the payment to Ms. Kloes should be reimbursed with soft dollars. (Division's Initial Brief, pp. 29-31.) Drennan, at Mausner's instruction, manufactured the purported excerpt of a contract between J.S. Oliver and Ms. Kloes even though no such contract existed. (Trial Tr. (Drennan) 1174:14-1176:9.) Mausner did send an email to Instinet, forwarding the fabricated "excerpt" of

the contract that Drennan had created at Mausner's direction. (Div. Ex. 70.) The fictitious "excerpt" satisfied Instinet, and Drennan thereafter approved the payment on J.S. Oliver's behalf in Instinet's online soft dollar system. (Trial Tr. (Kellner) 415:23-416:4; Trial Tr. (Drennan) 1022:20-25; Div. Exh. 140 at INST-4th 015518.)

Mausner's and Drennan's fraudulent scheme described above extinguish any possibility that respondents could assert "reliance on Instinet" as a valid claim. Drennan and Mausner affirmatively misrepresented that Ms. Kloes had worked on "organizational and accounting issues," that J.S. Oliver wanted to keep Ms. Kloes on as a consultant, and that an agreement existed between Ms. Kloes and J.S. Oliver to pay her a salary through 2011. They conjured up a document in an attempt to corroborate their false statements. And, of course, at no point did Mausner or Drennan disclose that the payment to Ms. Kloes was made "in lieu of" spousal support. Such actions unquestionably do not constitute making "complete disclosure of all material information," or relying on good faith on advice from a professional, which would be required for a reliance on counsel defense.

Notably, respondents cling to the dubious assertion that any counsel vetted and approved their actions, even though there is no contemporaneous evidence to support such a claim. The Court questioned respondents about this deficiency:

| | |
|---|---|
| Judge Murray: | Do you have anything in writing from the law firm to support what you say? |
| [Drennan]: | We don't. I don't. |

(Trial Tr. (Drennan) 1022:9-11.)

| | |
|---|---|
| Judge Murray: | Do you have anything in writing from the law firm to support what you say? |
| [Mausner]: | Unfortunately, we don't.... |

(Trial Tr. (Mausner) 1306:8-10.)

Indeed, the evidence is clear that respondents never broached the subjects with J.S. Oliver's counsel. On multiple occasions, Drennan and Mausner testified that they did not solicit (or, at best, could not remember soliciting) counsel's advice on their representations to Instinet. (*See, e.g.*, Trial Tr. (Drennan) 1011:23-1012:3; 1021:3-11.) For example, Mausner had no recollection of providing counsel with the fabricated purported contract "excerpt" that respondents provided to Instinet:

> Q. Okay. But you don't know one way or another whether you gave [Mr. Whatley] the actual excerpt that you provided to Instinet?
> A. I don't know whether he got that or not.

(Trial Tr. (Mausner) 1031:3-7.) Drennan specifically testified that he had no communication with counsel, and he was not aware of Mausner having any communication with counsel, regarding the fabricated contract "excerpt" that they submitted to Instinet:

> Q. So on June 1, 2009, as you were working with Mr. Mausner to prepare this excerpt, did you send it to Mr. Whatley and ask him to review it before you sent it to Instinet?
> A. I did not. No, I didn't. And I wish I had because I feel like I made a couple of mistakes, and it could have been better.

(Trial Tr. (Drennan) 1022:2-8; *see also* Trial Tr. (Drennan) 1174:7-13.)

> Q. Did – to your knowledge, did Mr. Mausner contact any outside counsel for J.S. Oliver to determine whether it was appropriate to change in this document you're creating, to take out Ian Mausner and put in J.S. Oliver Capital Management LP?
> A. I don't.
> Q. Did you have any communication on or around June 1, 2009, with any outside counsel for J.S. Oliver about whether it was appropriate to change the characterization of this document as being between J.S. Oliver Capital Management and Gina Mausner rather than in being between Ian Mausner and Gina Mausner?
> A. I'm sorry. It kind of went on. Are you asking if I did or Ian? Could you repeat, please?
> Q. If you did. If you did so. My question is did you have any communication with outside counsel about the change Mr. Mausner asked you to make in this PDF changing Ian Mausner to J.S. Oliver Capital Management?
> A. No.

(Trial Tr. (Drennan) 1017:18-1018:11.)

Respondents presented no testimony from any of their lawyers, presented no documents from their lawyers corroborating the advice they purportedly received, and did not substantiate their claims of advice of counsel in any way. Because there is no evidence whatsoever that respondents sought the advice of counsel regarding their plans to lie to Instinet and fabricate the purported excerpt and provide it to Instinet, their claims of reliance on counsel should be rejected.

**b) Payment of inflated "rent" to Mausner**

**i. The use of client soft dollars to pay inflated rent to Mausner was not disclosed to J.S. Oliver's clients or to J.S. Partners investors**

Respondents' argument that J.S. Oliver's offering documents and Form ADV disclosed to J.S. Oliver's clients the use of client soft dollars for the payment of rent is, at best, misleading. For example, Drennan states that the Fund I offering memorandum discloses the payment of rent because a short introductory paragraph states generally that J.S. Oliver "may cause" certain categories of overhead expenses to be paid using soft dollars. (Div. Exh. 160 at JSO 001354.) But Drennan obfuscates the fact that the section of the offering memorandum that describes in detail J.S. Oliver's soft dollar practices clearly does not permit the payment of rent with soft dollars. In the Fund I offering memorandum, the relevant disclosures under "Brokerage and Transactional Practices" (under the heading "Soft Dollars") provide that soft dollars may be used only for "such 'overhead' expenses as telephone charges, legal and accounting expenses of the Investment Manager or General Partner and office services, equipment and supplies." (Div. Exh. 160 at JSO 001375-76; *see also* Div. Exh. 411 at JSO 001163 (Fund II offering memorandum); Div. Exh. 412 at JSO 00114 (Offshore Fund offering memorandum) Div. Exh. 86 at JSO 000384-385 (J.S. Oliver's Form ADV, Part II.)) The payment of rent with client soft dollars is

not disclosed anywhere in these offering documents. Drennan's distorted reading of J.S. Oliver's offering documents is disingenuous, if not outright deceptive.

Additionally, although the CGF offering memorandum alone allowed for the payment of rent, the narrow disclosure therein was far from adequate to disclose to clients what Mausner and Drennan were doing with their soft dollars. The CGF offering memorandum certainly did not disclose that J.S. Oliver would use soft dollars to pay inflated rent to a company Mausner owned on a property that Mausner also used for personal purposes. And it unquestionably did not disclose that Mausner could funnel hundreds of thousands of dollars in excess "rent" payments to himself. *See SEC v. Syron*, 2013 U.S. Dist. Lexis 48183, at *50 (S.D.N.Y. March 28, 2013) (a party "ha[s] a duty to be both accurate and complete" with respect to disclosures of material issues so as to avoid rendering statements misleading").

Respondents' remaining attacks on the Division's assertions miss the mark. The issue is not, as Drennan suggests, whether the monthly rate was "perfectly set at market rates." (Drennan Br., p. 66.) The real issue is whether the respondents adequately disclosed soft dollar payments with enough specificity so that clients could understand what was being done with their soft dollars. Respondents clearly did not make such disclosures to their clients here. (*See, e.g.*, Trial Tr. (Hall) 794:17-25; Trial Tr. (Mahler) 824:1-10.)

**ii. The improper use of client soft dollars to pay excessive "rent" payments to Mausner was not disclosed to counsel**

Contrary to their arguments, respondents never disclosed to J.S. Oliver's counsel that they used soft dollars to pay excessive "rent" for Mausner's home and to funnel substantial excess cash to Mausner's personal bank account. After increasing the rent on Mausner's home from $6,000 per month (immediately before Mausner learned that he the rent could be paid with client soft dollars), to $10,000 per month and then to $15,000 per month in the span of six

months, Mausner began siphoning off a "usual monthly amount" of $10,000 from the inflated rent, which was transferred each month into Mausner's personal bank account. (Div. Exh. 310; Trial Tr. (Mausner) 1313:4-1314:21.) Notably, there is no evidence that counsel ever advised respondents that they could make such inflated rent payments with soft dollars. In fact, Mausner testified that he could not remember any discussion with counsel regarding the lease payments:

> Q. Mr. Mausner, isn't it true that you don't even know if you talked to Howard Rice about any rent payments?
> A. I don't recall specific conversations, no.
> Q. You don't recall any conversations, do you?
> A. I don't recall the specifics of conversations, but I know for sure that discussions occurred between Howard Rice and J.S. Oliver that was fully vetted, but I don't remember the specific conversations.
> Q. Well, why don't we have you turn to the June 27 transcript together, Mr. Mausner, and specifically to page 367. And specifically lines 8 through 12. Question. But you don't recall ever personally having a conversation with anyone at Howard Rice regarding the lease payments, is that correct? Answer. I don't recall having it, but it could have happened. And that was your testimony, correct?
> A. That is not at all contradictory.

(Trial Tr. (Mausner) 1315:6-24.) In addition, Mausner had no recollection of ever consulting with counsel regarding whether it would be appropriate to transfer excess "rent" payments to Mausner's personal bank account. (Trial Tr. (Mausner) 1316:10-1317:6.) In short, there is a complete lack of evidence of any consultations with counsel regarding the "rent" payments or the funneling of excess funds to Mausner, and absolutely no support for a claim of reliance on counsel in connection with the "rent" payments.

#### iii. Drennan played a significant role in the rent payments

Contrary to Drennan's assertions in his post-hearing brief, Drennan had a significant role in securing soft dollar payments from Instinet to Mausner's entity, JO Samantha, for rent. After initially setting up the account with Instinet for payment of soft dollars, Drennan worked directly with Mr. Driscoll to get Instinet to pay J.S. Oliver's rent payments. On behalf of J.S. Oliver,

Drennan (1) sent the CGF offering memorandum to Mr. Driscoll, which was the only J.S. Oliver offering memoranda that contained a client disclosure of rent, (2) provided rent invoices to Mr. Driscoll for payment, (3) filled out the W-9 for JO Samantha for submission to Instinet in support of soft dollar payments, (4) regularly followed up with Driscoll to inquire about the status of those payments, and then (5) once Instinet agreed to pay the rent invoices, clicked on the "approval" button in Instinet's online soft dollar system for authorization of the payment (a necessary last step before Instinet made the payment). (Div. Exhs. 42, 48, 140, 334, 335, 424.) Drennan also knew that Mausner transferred the money in excess of rent from JO Samantha to Mausner's personal bank account. (Div. Ex. 351.) Thus, it is clear that Drennan had a substantial role and knowledge about the "rent" payments using J.S. Oliver's soft dollars.

**c) Payment of Mausner's timeshare expenses**

**i. The use of client soft dollars to pay Mausner's personal timeshare expenses was not disclosed to J.S. Oliver's clients or to J.S. Partners Funds' investors**

Mausner and J.S. Oliver argue in their post-hearing brief that owning the timeshare "significantly reduc[ed] the hotel cost to the firm." (Mausner Br. at 35.) The question, however, is not whether it made business sense for Mausner to own a timeshare and use it when he traveled to New York, but whether the annual payment of maintenance fees and taxes on his personal timeshare should be paid with J.S. Oliver's clients' assets in the form of soft dollars. It should not. Mausner and J.S. Oliver did not disclose to their clients that they used client soft dollar credits to pay fees and expenses on Mausner's personal timeshare at the St. Regis luxury hotel in New York City. The relevant disclosure in J.S. Oliver's Form ADV, Part II and J.S. Partner Funds' offering memoranda provided that soft dollars may be used to reimburse travel expenses related to conferences only, and the CGF offering memorandum allowed soft dollar payments for "travel, meals and lodging" only if it was connected to a "potential investment

opportunity." (Div. Exh. 86 at JSO 000384-385; Div. Exh. 160 at JSO 001375-76; Div. Exh. 411 at JSO 001163; Div. Exh. 412 at JSO 00114.) Payment of maintenance fees and taxes on a personal timeshare is a far cry from "lodging" expenses. Moreover, there is no evidence that Mausner attended any conferences in connection with his use of the timeshare. In fact, Mausner admitted to using the timeshare for personal purposes such as visiting family members and trips with girlfriends. (Trial Tr. (Mausner) 1323:7-18.) Such uses of soft dollars were never disclosed to J.S. Oliver's clients.

**ii. The improper use of soft dollars to pay Mausner's personal timeshare expenses was not disclosed to counsel**

Lastly, contrary to Mausner's bald assertions in his post-hearing brief, Mausner presented no evidence at the hearing that he disclosed to counsel the use of soft dollars to pay annual maintenance fees and taxes on his personal timeshare, that he requested counsel's advice as to the legality of the payments, or that he, in fact, received advice that the conduct was legal. Thus, any reliance on counsel assertion must fail.

**d) Payments to Drennan through Powerhouse**

**i. Respondents' use of soft dollars to pay Drennan more than $480,000 in salary and bonuses was not disclosed to J.S. Oliver's clients or to J.S. Partners Funds' investors**

In their post-hearing briefs, respondents falsely contend that J.S. Oliver's disclosure documents permit the use of client soft dollars for employee salaries. (Drennan Br., pp. 29-32; Mausner Br., p. 36.) First, Drennan submitted soft dollar invoices both to Instinet and BTIG as payments under the Section 28(e) safe harbor, not as expenses of an employee. (Trial Tr. (Drennan) 874:9-13.) As Drennan knew, BTIG only paid soft dollar invoices under Section 28(e), and employee salaries fall outside Section 28(e). (Trial Tr. (Drennan) 897:13-16; 875:2-

9.) Thus, any argument that Drennan makes now regarding payments to him as employee salary is completely disingenuous.

Second, this misleading argument depends on an unsupportable reading of J.S. Oliver's soft dollar disclosures. Similar to his deceptive argument regarding the inflated rent, Drennan relies exclusively on language in a short introductory paragraph that states generally that J.S. Oliver "may cause" certain categories of operating costs to be paid using soft dollars. Drennan cherry-picks language from the offering memoranda to try to make it appear, wrongly, that "professional fees" or "expenses related to the management and operation of the Fund" should be understood to encompass employee salaries and six-figure bonuses. But Drennan completely ignores the fact that the section of the offering memoranda that expressly sets forth J.S. Oliver's soft dollar practices does not disclose the payment of employee salaries with soft dollars (except for the CGF offering memorandum). The permissible uses of soft dollars disclosed in the J.S. Partners Funds' offering memoranda and J.S. Oliver's Form ADV are limited to "such 'overhead' expenses as telephone charges, legal and accounting expenses of the Investment Manager or General Partner and office services, equipment and supplies." (Div. Exh. 160 at JSO 001375-76; *see also* Div. Exh. 411 at JSO 001163 (Fund II offering memorandum); Div. Exh. 412 at JSO 00114 (Offshore Fund offering memorandum) Div. Exh. 86 at JSO 000384-385 (J.S. Oliver's Form ADV, Part II.)) Drennan's argument that this language should encompass employee salaries flies in the face of a plain reading of J.S. Oliver's soft dollar disclosures. No reasonable investor or client would read the J.S. Partners Funds' or Form ADV soft dollar disclosures to cover employee salaries and six-figure bonuses. In stark contrast, the CGF offering memorandum clearly states that soft dollars may be used for "such 'overhead' expenses as office rent, salaries, benefits, and other compensation of employees or of consultants to the Investment Manager..." (Div. Exh. 135 at INST 000064.)

### ii. There is strong evidence of Drennan's scienter regarding the improper use of soft dollars to pay salary and bonuses to Drennan through Powerhouse Capital

While the evidence satisfies an actual knowledge standard based on Drennan's conduct, actual knowledge is not required to establish aiding and abetting liability. Contrary to Drennan's argument, in administrative proceedings the Commission applies a "recklessness" standard for aiding and abetting liability where, as here, the aider and abettor is associated with an investment adviser. *See In the Matter of Daniel Bogar, et al.*, Initial Decisions Rel. No. 502, 2013 SEC Lexis 2235 at *63-66 (Aug. 2, 2013); *see also In the Matter of vFinance Investments, Inc., et al.*, Exchange Act. Rel. No. 62448, 2010 SEC Lexis 2216 at *46-47 (July 2, 2010) (Commission Opinion); *Voss v. SEC*, 222 F.3d 994, 1004-06 (D.C. Cir. 2000); *Ponce v. SEC*, 345 F.3d 722, 737-38 (9th Cir. 2003) (upholding the application of the Commission's recklessness standard in an administrative proceeding). The recklessness standard is satisfied where the respondent fails to use due diligence to investigate a circumstance with unusual factors or ignores red flags or suggestions of irregular conduct.[9] *See Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004). In addition, only negligence is required for "causing" liability. *See In the Matter of Robert M. Fuller*, Exchange Act Rel. No. 48406, 2003 SEC Lexis 2041 at *21, n.29 (Aug. 25, 2003). Regardless, as presented by the evidence at the hearing, Drennan's conduct is more than reckless and satisfies an actual knowledge standard.

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[9] Also, contrary to Drennan's assertion, there is no requirement for aiding and abetting liability that the respondent control the entity that committed the primary violation. As an example, the Commission recently found that two registered representatives aided and abetted and caused a broker-dealer's violations of Section 17(a) of the Securities Exchange Act of 1934 by failing to file required suspicious activity reports. *In the Matter of Ronald S. Bloomfield, et al.*, Exchange Act Rel. No. 71632 (Feb. 27, 2014) (Commission Opinion); *see also In the Matter of Chris Woessner*, Initial Decisions Rel. No. 225, 2003 SEC Lexis 646 (March 19, 2003); *In the Matter of Performance Analytics, Inc., et al.*, Advisers Act Rel. No. 2036, 2002 SEC Lexis 1552 (June 17, 2002).

Drennan argues in his post-hearing brief that he sent only the CGF offering memorandum to Instinet because he "wanted Instinet to have accurate documents" as evidence of his lack of scienter. (Drennan Br., pp. 33-37.) He cites to an elaborate chronology that he says supports this conclusion. But Drennan's argument is contradicted by the facts. Drennan knew what narrow soft dollar disclosures were included in, for example, the Fund II offering memorandum because he had previously reviewed it. (Trial. Tr. (Drennan) 926:18-22.) He knew what narrow soft dollar disclosures were included in J.S. Oliver's Form ADV, Part II because he was the point person in drafting it. (Trial Tr. (Mausner) 1226:11-1228:8.) Drennan sent the CGF offering memorandum to Instinet, and then made statements at the hearing that he – quite recklessly, if true – did not take the time to review the disclosures contained therein before he sent it. (Trial Tr. (Drennan) 1093:22-1094:1.) Yet, having read the Fund II memorandum, Drennan knew that those disclosures did not cover employee salaries. (Trial Tr. (Drennan) 928:20-24.) Knowing that J.S. Oliver's soft dollar disclosures would not cover employee salaries, Drennan cannot escape liability.

### iii. Drennan's contention that his work for J.S. Oliver was "almost entirely" research related is contradicted by the evidence

Drennan's assertion that his work was "almost entirely research related" when he returned to J.S. Oliver in early 2009 is simply not true. The evidence shows that Drennan performed a wide variety of non-research-related duties upon his return to J.S. Oliver. Among other things, Drennan:

(1) served as one of the primary contacts for J.S. Oliver in its soft dollar relationship with Instinet (Trial Tr. (Driscoll) 247:5-6; 256:18-21; 277:21-278:3; 279:6-9; 280:7-11; Div. Exh. 52);

(2) was, along with Mausner, one of only two J.S. Oliver employees who could initially approve soft dollar invoices on Instinet's online system, and instructed Instinet to give Ms. Kartes "view-only" access (Trial Tr. (Drennan) 950:21-25; Div. Ex. 334, at INST-5th 396447);

(3) entered trades on behalf of J.S. Oliver beginning in January 2009 (Trial Tr. (Mausner 1329:1-16);

(4) had complete access to J.S. Oliver's computers and client files (Trial Tr. (Drennan) 850:8-852:5);

(5) used a "jsoliver.com" email address and J.S. Oliver's telephone number for his communications (*id.*);

(6) supervised J.S. Oliver's accounting and financial reporting (Trial Tr. (Kartes) 647:5-648:1; Div. Exhs. 205, 421, 426, 427, 549, 550, 553, 556, 565, 566, 567, 568, 575, 578);

(7) served as a J.S. Oliver "team leader" (Trial Tr. (Kartes) 581:24-582:17; 583:12-17; Trial Tr. (Mausner) 1327:5-1328:8; 1328:19-24);

(8) sent other J.S. Oliver employees weekly emails with tasks for them to perform, and made sure deadlines were met (Trial Tr. (Mausner) 1328:19-24; Trial Tr. (Kartes) 582:11-17);

(9) represented himself as a "trader" and as J.S. Oliver's primary contact in its account opening documents with Instinet, and as J.S. Oliver's backup contact with BTIG (Div. Exh. 306 at INST-5th 396224 and 396258; Trial Tr. (Endres) 530:8-24; Div. Exh. 706); and

(10) signed documents as a "trader" for J.S. Oliver in February 2009, giving him trading authorization on the J.S. Oliver account, and was active in troubleshooting

issues with trades and commissions (Trial Tr. (Mausner) 1325:15-23; Div. Exh. 418).

In fact, even when Mausner was in the office, Drennan was known to resolve conflicts among the other J.S. Oliver employees. (Trial Tr. (Kartes) 582:11-17.) Indeed, Mausner did not consider there to be much of a difference between what Drennan did before he left J.S. Oliver and when he returned in 2009, and Mausner referred to Drennan's return to J.S. Oliver as "get[ting] a great employee back for free." (Trial Tr. (Mausner) 1329:1-16; 1329:25-1331:9.) The fact that Drennan was performing significant, non-research-related activities was further corroborated by Ms. Kartes, to whom Drennan admitted that he had received a $100,000 bonus for his work in setting up J.S. Oliver's soft dollar program. (Trial Tr. (Kartes) 649:20-651:5.)

**iv. Defendants have the burden to prove reliance on counsel, which they have not satisfied regarding the payments of salary and bonuses to Drennan through Powerhouse**

The Division does not carry a burden to disprove a respondent's purported reliance on counsel. As stated above, the burden is on the respondent to establish each element of a reliance on counsel defense, and the claim fails where any of these elements are not proven. *See AIC, Inc.*, 2013 U.S. Dist. Lexis 130249 at *22. A respondent must prove that he or she made a complete disclosure to counsel of all material information, requested counsel's advice as to the legality of the contemplated action, received advice that the conduct was legal, and relied in good faith on that advice. *SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 467 (9th Cir. 1985).

Respondents have not come close to satisfying their burden of proving reliance on advice of counsel regarding the Powerhouse payments. There is no evidence that respondents ever disclosed to J.S. Oliver's counsel that Drennan performed a wide variety of non-research-related duties upon his return to J.S. Oliver. For example, there is no evidence that respondents disclosed to counsel any of Drennan's ongoing work described above, including setting up the

soft dollar relationship with Instinet, and continuing to be its primary contact for J.S. Oliver, entering trades, accessing all of J.S. Oliver's computer files, using J.S. Oliver's email and phones, and acting as "team leader" to supervise employees and sending them weekly tasks to complete and making sure deadlines were met. Nor is there any evidence that respondents disclosed to counsel that Drennan received a $100,000 bonus for his work in setting up J.S. Oliver's soft dollar program.

In fact, the only contemporaneous documentary evidence directly contradicts Drennan's testimony that J.S. Oliver's counsel had approved his payment in soft dollars through Powerhouse. In August 2009, eight months after Drennan began working for J.S. Oliver purportedly under Powerhouse, Drennan contacted J.S. Oliver's counsel, Mark Whatley, to ask whether soft dollar payments to Drennan for research services were proper. (Trial Tr. (Drennan) 1024:24-1025:23.) Mr. Whatley advised Drennan that "particularly where a research consultant has previously been an employee, the SEC can take the position that a purported independent contractor-consulting arrangement really amounts only to an employment arrangement." (Div. Exh. 247.) Mr. Whatley further advised Drennan that payments to him in that situation were "not eligible for payment under 28(e)." (*Id.*)

### C. J.S. Oliver and Mausner Do Not Contest Their Violations of the Books and Records, Form ADV, and Written Policies and Procedures Provisions Under the Advisers Act

The Division presented evidence at the hearing on this action that J.S. Oliver violated, and Mausner aided and abetted and caused its violations of, Section 204 of the Advisers Act and Rules 204-2(a)(3) and (7) thereunder, by failing to "make and keep" required records, including trade orders and written communications from an investment adviser, and Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, by failing to adopt and implement written policies and procedures reasonable designed to prevent violations of the Advisers Act. The Division also

presented evidence that Mausner and J.S. Oliver violated Section 207 of the Advisers Act and Rule 204-1(a)(2) thereunder by making a false statement in a Form ADV. In their initial brief, Mausner and J.S. Oliver do not challenge their violations of, or, where applicable, Mausner's aiding and abetting and causing violations of, these provisions.

### D. The Requested Relief is Appropriate

The relief sought against Mausner and J.S. Oliver, including a cease-and-desist order, an industry bar against Mausner and revocation of J.S. Oliver's status as an investment adviser, joint and several disgorgement of $1,376,440 (the aggregate amount they benefited from improper soft dollar payments and performance fees paid by CGF in 2008), plus prejudgment interest of $136,639, and third-tier civil penalties of $3.3 million against Mausner and $15.95 million against J.S. Oliver, is appropriate. The requested relief against Drennan, including a cease-and-desist order, disgorgement of $482,381 (the amount he received in improper soft dollar payments) plus prejudgment interest of $47,886, and a third-tier civil penalty for each of his violations, totaling $450,000, is also appropriate.

Respondents' arguments against the requested relief should be rejected. Indeed, respondents' continuing denials that any violations occurred, in the face of overwhelming evidence to the contrary, supports the imposition of severe sanctions. For example, Drennan continues to deny that he engaged in "any acts involving fraud, deceit, or manipulation," and argues that he "was not unjustly enriched." (Drennan Br., p. 72.) Mausner still tries to deflect blame for the soft dollar violations to others. Statements by Mausner such as "[t]he guilty parties here are Howard Rice and Instinet not JSO" evidence a complete lack of responsibility for his egregious violations. (Mausner Br., p. 51.) Mausner's and Drennan's unwillingness to acknowledge the wrongful nature of their conduct supports banning them from the securities

industry and the imposition of substantial civil penalties against them. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979).

Respondents' arguments that quibble with the Division's disgorgement calculation are meritless. The Division reasonably calculated the amount of profits earned by respondents as a result of their violations. The burden then shifts to respondents to demonstrate that the disgorgement figure is not a reasonable approximation, which respondents have not done here. *SEC v. Platform Wireless Int'l Corp.*, 617 F.3d 1072 (9th Cir. 2010). Indeed, because a defendant or respondent is more likely to have access to evidence establishing the amounts of proceeds that were generated through illegal conduct, "the risk of uncertainty [regarding disgorgement] should fall on the wrongdoer whose illegal conduct created that uncertainty." *Id.* "[S]ince calculating disgorgement may at times be a near-impossible task, ... all doubts concerning the determination of disgorgements are to be resolved against the defrauding party." *SEC v. Great Lakes Equities Co.,* 775 F. Supp. 211 (E.D. Mich. 1991).

In addition, the sanctions that should be ordered against Drennan should not be reduced based on his claimed inability to pay. Drennan submitted financial disclosures that showed assets of nearly a million dollars, and a net worth of more than $361,000. Far from establishing inability to pay, Drennan's financial disclosures reveal substantial assets that could be used to satisfy a judgment against him. But more importantly, even when a respondent is able to demonstrate an inability to pay (unlike Drennan), the hearing officer and the Commission "have discretion not to waive the penalty, particularly where the misconduct is sufficiently egregious." *In the Matter of David Henry Disraeli, et al.*, Advisers Act Rel. No. 2686, 2007 SEC Lexis 3015 at *82 (Dec. 21, 2007) (Commission Opinion); *see also In the Matter of Charles Trento*, Exchange Act Rel. No. 49296, 2004 SEC Lexis 389 (Feb. 23, 2004) (Commission Opinion) ("Even accepting [respondent's] financial report at face value, we find that the egregiousness of

his conduct far outweighs any consideration of his present inability to pay a penalty"). Here, Drennan's conduct was sufficiently egregious that it outweighs any financial information submitted by him. Full disgorgement and a substantial civil penalty are necessary to deter others from committing similar violations.

Finally, respondents' arguments that they have already suffered serious consequences as a result of their actions should have no impact on the sanctions to be imposed against them. For example, the Commission has flatly rejected the argument that imposing a bar is unnecessary in light of other consequences a respondent may have suffered. In *In the Matter of Vladimir Boris Bugarski*, Exchange Act Rel. No. 66842, 2012 SEC Lexis 1267, at *17-18 (April 20, 2012), the respondents argued that "the imposition of additional remedial action against them would be simply adding to the severe sanctions that have already been imposed and would not be in the public interest." The Commission soundly repudiated their argument:

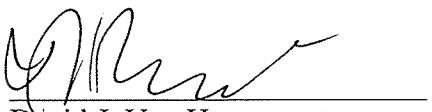
> We reject this argument. While the sanctions imposed by the district court – the permanent injunction, disgorgement, and third-tier civil penalties – are severe, this simply underscores the seriousness of Respondents' misconduct. Indeed, conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws.

## III. CONCLUSION

For all the reasons stated, the Division requests that the Court find that respondents Mausner and J.S. Oliver have violated, and that respondent Drennan has aided and abetted, and caused their violations of, the specified provisions of the federal securities laws and impose the requested sanctions.

Dated: April 11, 2014

Respectfully submitted,



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