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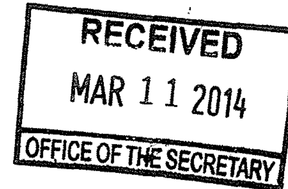
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15617

In the Matter of

LARRY C. GROSSMAN and GREGORY J. ADAMS,

Respondents.

DIVISION OF ENFORCEMENT'S PREHEARING BRIEF

Patrick R. Costello
Senior Trial Counsel
Direct Line: (305) 982-6380
Email: costellop@sec.gov

DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
801 Brickell Avenue, Suite 1800
Miami, FL 33131
Phone: (305) 982-6300
Fax: (305) 536-4154

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I. INTRODUCTION

This matter involves investment adviser fraud, breaches of fiduciary duty and other violations of the securities laws by two principals of Sovereign International Asset Management, Inc. ("Sovereign"), an investment adviser registered with the Commission until February 6, 2013.

Respondents Larry C. Grossman and Gregory J. Adams solicited and directed Sovereign's advisory clients to invest and remain invested almost exclusively in hedge funds and a managed account controlled by Nikolai Battoo, who is currently a fraud defendant in *SEC v. Nikolai S. Battoo, et al.*, N.D. Ill. Case No 12-CV-7125. Grossman and Adams misrepresented their compensation and failed to disclose to Sovereign's clients that in exchange for recommending they invest in Battoo's hedge funds and managed accounts, Battoo paid Grossman and Adams approximately $3.3 million and $1 million, respectively.

In addition, at investment conferences and in written materials, Grossman and Adams represented to prospective clients that they chose Battoo's funds based on an extensive selection and due diligence process. They further promoted Battoo's funds as safe, diversified, independently-administered, and audited, and suitable for the investment objectives and risk profiles of their clients, most of whom were retirees. In fact, investments in Battoo's funds were risky, lacked diversification, and lacked independent administrators and auditors. Grossman and Adams also failed to investigate, and in some cases wholly disregarded, numerous red flags concerning Battoo and his funds.

The material facts are straightforward, and the evidence fully supports the allegations of the Division of Enforcement set forth in the November 20, 2013 Order Instituting Proceedings ("OIP").[1]

[1] As the Law Judge is aware, Adams has offered to consent to a bifurcated settlement under which the allegations of the OIP are deemed established against him, and under which he agrees to a cease-and-desist order

II. RESPONDENTS AND RELATED PARTIES

A. Respondents

1. **Grossman** was Sovereign's founder, managing partner, and sole owner from 2001 until October 2008, when he sold Sovereign and three related entities (Anguilla-registered Sovereign International Asset Management, LLC ("SIAM, LLC"), Florida-based Anchor Holdings, LLC ("AH Florida"), and Nevis-based Anchor Holdings, LLC ("AH Nevis")) to Adams. Grossman currently is the principal manager of Sovereign International Pension Services, Inc., an IRA administrator ("SIPS").

2. **Adams** was Sovereign's managing partner and sole owner from October 2008 to its dissolution at the end of September 2012. Adams, a former insurance salesman, bought Sovereign, SIAM, LLC, AH Florida, and AH Nevis from Grossman in October 2008. He currently owns and manages Sovereign Private Wealth, Inc., an investment adviser registered with the Commission until December 17, 2012 (at which point it had approximately $15 million in assets under management). Adams is the managing director of Weybridge Capital Limited, which manages the BVI-registered and licensed Sheffield family of funds. On May 15, 2013, Adams filed a Chapter 7 bankruptcy petition.

B. Related Parties

1. **Sovereign** was a Florida corporation with its principal place of business in Clearwater, Florida, incorporated by Grossman in 2001. Sovereign registered with the Commission as an investment adviser on June 21, 2002. In October 2008, Grossman sold Sovereign to Adams. On June 28, 2012, Sovereign filed for Chapter 7 bankruptcy in the United

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and collateral associational bars. Thus, the sole issue for the Law Judge's consideration with regard to Adams is the amount of disgorgement, prejudgment interest and a third-tier civil penalty to impose against him. At the prehearing conference held on March 7, 2014, the Law Judge stayed the case against Adams in order to enable the Commission to consider Adams' offer.

States Bankruptcy Court for the Middle District of Florida, claiming liabilities of more than $53 million. The State of Florida administratively dissolved Sovereign at the end of September 2012. Pursuant to Section 203(h) of the Advisers Act, the Commission canceled Sovereign's registration on February 6, 2013.

2. **SIAM, LLC** is a limited liability company Grossman formed in April 1999 and registered in Anguilla. SIAM, LLC's sole business was to offer consulting services to Battoo-controlled entities. To that end, it entered into a number of referral agreements with various entities Battoo owned or controlled and was paid by these entities. Grossman sold SIAM, LLC to Adams in conjunction with the sale of Sovereign in October 2008.

3. **AH Florida** is a limited liability company Grossman registered in Florida in 2005, using the same "Anchor Holdings" name as AH Nevis. Grossman sold AH Florida to Adams in October 2008. AH Florida was dissolved in September 2012.

4. **AH Nevis** is a company Grossman formed and registered in Nevis in September 2004. Grossman sold AH Nevis to Adams in conjunction with the sale of Sovereign in October 2008.

5. **Battoo** is the principal of BC Capital Group, S.A. (Panama) and BC Capital Group Limited (Hong Kong), collectively referred to herein as "BC Capital." Through BC Capital, Battoo operated offshore hedge funds. He also offered managed account services through Private International Wealth Management ("PIWM"). The District Court fraud action the Commission filed against Battoo alleged, among other things, that he exaggerated the value of the assets he managed, falsified his track record of benchmark-beating returns, and concealed major losses from investors.

6. **Anchor Hedge Fund Limited** ("Anchor Hedge Fund") was incorporated in the British Virgin Islands in September 2002. Grossman was a consultant to Anchor Hedge Fund and, along with Battoo, a member of its investment advisory board until 2008.

7. **Anchor Hedge Fund Management Limited** ("AHF Management"), formed in Hong Kong in 2004, was the investment manager of Anchor Hedge Fund and owned all of its non-participating voting common shares. BC Capital Group Limited (Hong Kong) had a majority ownership interest in AHF Management. Battoo owned BC Capital Group Limited (Hong Kong), and thus controlled a majority ownership interest in Anchor Hedge Fund.

III. FACTUAL BACKGROUND

A. Overview

1. Sovereign's Operations

Sovereign was a small organization run by Grossman, Sovereign's sole control person, until he sold it to Adams in October 2008. Sovereign employed a small staff, mostly of support personnel, of less than ten people. No one at Sovereign was a registered representative associated with a broker-dealer during the relevant time period. At its peak in 2008, Sovereign reported it had $85 million in assets under management.

Sovereign and Grossman targeted retirees seeking to invest their money offshore, and for the most part Sovereign's clients were retirees with self-directed IRAs. In Sovereign's promotional materials, such as PowerPoint presentations, Grossman represented to clients that Sovereign "use[d] an extensive investment selection process that [was] not only qualitative but incorporate[d] a significant due diligence process as well." Despite this claim, the evidence indicates that Grossman, and later Adams, advised Sovereign clients to invest almost exclusively in the following hedge funds and a managed account controlled by Battoo, regardless of the clients'

investment objectives: Anchor Hedge Fund Classes A, B, C and E (the "Anchor Funds"); FuturesOne Diversified Fund Ltd., ("FuturesOne") a mutual fund formed in the British Virgin Islands, for which Battoo was the sole member and chairman of its investment advisory board) (the Anchor Funds and FuturesOne are collectively referred to hereinafter as the "Battoo Funds"); and in PIWM, the managed account.

2. Grossman's Formation of AH Florida

Grossman formed AH Florida in 2005, using the identical "Anchor Holdings" name of AH Nevis, which, as noted above, was a separate entity Grossman formed in Nevis in 2004. Sovereign, through Grossman and later Adams (after he acquired AH Florida), instructed clients who wished to invest in the Battoo Funds or PIWM to transfer their money to AH Florida. Grossman and Adams did not tell clients, however, that Sovereign would pool their investment funds with other clients' investment funds in AH Florida's bank account. Each individual client completed an application for the shares in question, which led them to believe that they had individual investments.

After pooling client funds in AH Florida's bank account, Grossman, and later Adams, transferred the funds offshore to the Battoo Funds. Because of the similarity in names, clients believed that the AH Florida account was actually an account belonging to Anchor Hedge Fund. Although Grossman, and later Adams, provided Battoo with the names of their clients, Grossman and Adams did not make investments in the names of the individual clients but in the name of AH Nevis. As noted below, after these client investments were made, Battoo paid Sovereign and Grossman (and later Adams) referral, consulting, and cost-of-entry fees.

At no time did Sovereign clients receive statements from qualified custodians or from Sovereign regarding their investment funds deposited in AH Florida's bank account. Although

Sovereign sent statements to clients regarding their purported investments in the Battoo Funds, there were no surprise annual exams of Sovereign during the relevant period, as required by the Advisers Act.

3. Grossman's Sale of Sovereign to Adams

On October 1, 2008, Grossman sold Sovereign to Adams. On October 14, 2008, Adams emailed a letter signed by Grossman to Sovereign clients in which Grossman wrote that he "want[ed] to reiterate that our hedge fund investments are 'Fund of Funds' that are highly diversified with different managers, styles and strategies." Although the letter did not specifically refer to the Battoo Funds, the majority of Sovereign clients were invested almost entirely in the Battoo Funds. The letter introduced Adams and informed clients that Adams had been named Sovereign's President and Chief Investment Officer. The letter also stated Grossman would remain Managing Director of SIPS, which was "only a few doors from [Adams'] office," would remain on Sovereign's Board of Advisers, and would be "actively involved in the day-to-day strategy development as needed." Grossman continued to be listed as an associated person in Sovereign's Form ADV Part II, dated October 30, 2008. After the sale, and until approximately March 23, 2009, Grossman continued to act on behalf of Sovereign as a paid consultant, assisting Adams with client relations and also making specific investment recommendations to clients. Moreover, SIPS, the company Grossman controls, continued to act as an IRA administrator for Sovereign's clients.

B. Misrepresentations and Omissions to Investors

1. Grossman and Adams Failed to Disclose More Than $4.3 Million in Compensation from Battoo for Referring Clients and Providing Advisory Services to the Battoo Funds and PIWM

Grossman met Battoo at the end of 2002 at a conference in Panama. A few months later,

Sovereign sent an email to clients stating it had taken on an active role as an investment adviser to Battoo's Anchor Hedge Fund. Sovereign represented to clients it received no additional compensation, but was "privy to and part of many investment decisions that are made." Contrary to this representation, however, Sovereign was much more than an investment adviser to Anchor Hedge Fund. Indeed, Sovereign was a referral source for Battoo and the Battoo Funds.

Grossman, from August 2003 until at least March 2009, when he stopped acting as a paid consultant, and Adams, from October 2008 until August 2010, advised the overwhelming majority of Sovereign's clients to invest and remain invested almost exclusively in the Battoo Funds and PIWM.[2] Indeed, of the more than 500 clients that Sovereign had in the years leading up to the sale of the company to Adams, only ***six*** invested in hedge funds aside from the Battoo Funds and PIWM that Grossman recommended. In fact, as of October 1, 2008, when Grossman sold Sovereign to Adams, 75% of Sovereign's assets under management were invested in the Battoo Funds and PIWM, which were the largest part of Sovereign's business. And following the sale, no Sovereign clients invested or were invested in any hedge funds or managed accounts that were not affiliated with Battoo.

a. The Referral and Consulting Agreements with Battoo

From August to December 2003, Grossman signed three written referral agreements on behalf of SIAM LLC and one written consulting agreement on behalf of himself with funds and entities Battoo owned or controlled:

[2] The suspension of the redemptions in the Battoo Funds, discussed below, so adversely affected Sovereign that it declared bankruptcy in June 2012. The schedules and amended schedules filed with Sovereign's bankruptcy petition, when compared to Sovereign's client files, reflect that virtually all of the identified creditors consist of Sovereign clients who invested in the Battoo Funds and PIWM. The remaining non-client creditors are (a) entities owed fees and costs incurred due to litigation or other proceedings related to the Battoo Funds and PIWM; and (b) Grossman for the money purportedly still owed to him by Adams as a result of the sale of Sovereign.

- a referral agreement between SIAM LLC and Anchor Hedge Fund (the "Anchor Referral Agreement") effective August 1, 2003;
- a referral agreement between SIAM LLC and FuturesOne (the "FuturesOne Referral Agreement"), effective September 1, 2003;
- a referral agreement between SIAM LLC and BC Capital Group S.A. (Panama), which managed the PIWM account (the "PIWM Referral Agreement"), effective November 1, 2003; and
- a consulting agreement between Grossman and Anchor Hedge Fund's investment manager (the "Consulting Agreement"), effective December 1, 2003.

Each of these agreements provided for payment of sales loads, performance fees, management fees and other fees to Sovereign and Grossman. Under the Consulting Agreement, Grossman's duties included advising Anchor Hedge Fund's investment manager, analyzing the performance of Anchor Hedge Fund's investments, and preparing materials for monthly reports, among other things. A fourth agreement, not in writing, between Anchor Hedge Fund and SIAM LLC (the "Oral Agreement"), provided that SIAM LLC would receive the initial sales load, or cost-of-entry fee, of 4.5% charged to Sovereign's clients upon their investments in Anchor Hedge Fund and in PIWM

The Anchor Referral Agreement, the FuturesOne Referral Agreement, the PIWM Referral Agreement and the Oral Agreement triggered transaction-based referral fees to Sovereign paid to SIAM LLC. The Consulting Agreement triggered consulting fees paid to Grossman. Pursuant to all of these agreements, beginning in at least 2004, Battoo paid Sovereign through SIAM, LLC's account at Jyske Bank in Denmark for referrals of clients to the Battoo Funds and PIWM. After the sale of Sovereign to Adams, and continuing through 2010, Battoo continued to pay Sovereign through SIAM, LLC.

The Division expects the evidence will show that all fees and compensation under these agreements were paid to Sovereign, Grossman and Adams through SIAM LLC's bank account at Jyske Bank in Denmark. In addition, the evidence also will show that this account was not used for any purpose other than receipt of fees under the agreements.

b. Grossman and Adams Misrepresented Their Compensation and Failed to Disclose the Agreements With Battoo.

Grossman and Adams misrepresented their compensation and failed adequately to disclose their conflicts of interest to Sovereign's clients.[3]

As an initial matter, Sovereign did not timely provide the required Form ADV Part II to all of its clients as required under Advisers Act Rule 204-3 (and clients did not consent to delivery through a website). Furthermore, the Form ADV Part II either omitted, or contained misleading statements regarding, additional compensation. For example, in one version of Sovereign's Form ADV Part II dated March 26, 2008, Sovereign, through Grossman, represented in Item 13 "Additional Compensation" that neither Sovereign nor a related person, *i.e.*, SIAM, LLC (an entity with common control), received additional compensation. In a later section, Sovereign disclosed that it "***may*** receive incentive or subscription fees from certain investment companies" (emphasis added). This disclosure was misleading because SIAM, LLC and Grossman actually were receiving compensation under the referral and consulting agreements with Battoo. Sovereign also represented in the Form ADV Part II that it would notify clients of any and all fees paid to Sovereign. Yet, Sovereign failed to provide any notice to its clients of the fees paid to Grossman and SIAM, LLC.

Sovereign's Form ADV Part 1 also was misleading, even after Adams purchased Sovereign in October 2008. Although Sovereign, through Adams, for the first time disclosed its referral fees

[3] Attached as Exhibits A and B to this pre-hearing brief are charts which contain a summary of all relevant disclosures and why the same were misleading.

in its Form ADV Part 1 dated April 6, 2009 under "Compensation Arrangements," that disclosure still was misleading. Among other reasons, Sovereign made the disclosure in response to questions on the form about its advisory business as opposed to more specific questions intended to elicit information about Sovereign's involvement in other business activities which could create potential conflicts of interest, such as Item 6.B.1 "Other Business Activities."

For many years, Sovereign's investment advisory agreement ("IAA") also was misleading and failed to contain any disclosures regarding the receipt of transaction-based compensation. Moreover, as with the Form ADV Part II, the IAA explicitly stated that Sovereign "will notify clients in advance of any investments the nature of ***any and all fees*** charged to the client and/or paid to Advisor." (Emphasis added.) Sovereign never provided its clients any such notification. Grossman and Adams gave the IAA to clients while being compensated for referring the same clients to Battoo.

In August 2006, Sovereign revised its IAA and disclosed that it "may receive performance-based compensation from certain investment companies." However, this language did not cover transaction-based compensation, such as referral fees to Sovereign or SIAM, LLC for recommending that clients invest in certain funds.

The private placement memoranda ("PPM") for the various classes of Anchor Hedge Fund in which Sovereign clients invested also did not disclose the fees Sovereign and Grossman received from Battoo. For example, the Anchor Hedge Fund Class A PPM listed Grossman and Battoo as members of the fund's investment advisory board. In Section 4.3, the PPM stated that the "Investment Adviser" appointed by the fund's investment manager (AHF Management) "will be paid fees and expenses as agreed by the investment manager." This provision could not have applied to the fees Battoo paid to Sovereign or Grossman, however, because (i) Sovereign is not

identified anywhere in the PPM as an investment adviser or member of the investment advisory board; (ii) Grossman is not listed as an "Investment Adviser" but only as a member of the investment advisory board; and (iii) Grossman previously has taken the position that despite being listed as a member of the investment advisory board, he did not provide any investment advisory services to the fund; accordingly, he could not have acted as an "Investment Adviser" who was entitled to fees from the fund.

In addition, in Section 5.2, the PPM listed the 4.5% cost-of-entry fee (sales load) that clients would pay for investing in the fund. However, the PPM stated only that the cost-of-entry fee may be used for "expenses of set up and distribution." It did not state that Sovereign or Grossman would receive the cost-of-entry fee pursuant to their referral agreements with Battoo for investing clients in his funds.

2. Grossman and Adams Misled Clients To Invest in Anchor Hedge Funds.

Beginning in August 2003, Grossman recommended investments in the Battoo Funds and PIWM to Sovereign's clients. Starting around October 2008, Adams advised clients to retain their investments in Anchor Hedge Fund. However, Grossman and Adams knowingly or recklessly misrepresented the risk and independence of the investments.

a. Cross Portfolio Liability

From 2003 until he sold Sovereign in 2008, Grossman recommended the Battoo Funds (and Anchor Hedge Fund in particular) and PIWM to Sovereign clients, almost exclusively. In turn, after purchasing Sovereign, Adams told clients to retain their investments. Grossman described Anchor Fund Classes A and B in written materials as moderately risky investments with goals of long-term capital appreciation and preservation. These classes, however, were subject to high risk. In fact, the assets of each class were available to meet the liabilities of the other classes,

something the funds did not disclose in the PPM. As a result, the investments in market neutral Anchor Classes A and B could be used to cover liabilities, including claims by investors and third parties, incurred by the higher risk and more volatile Anchor Class C. Grossman also did not disclose the exposure between the classes to clients who sought only moderately risky investments.

b. Anchor Hedge Fund Class A Did Not Invest in Safe, Diversified, Independently-Administered, and Audited Funds

Grossman recommended Anchor Class A as a safe fund that invested in a diversified selection of hedge funds and would deliver expected returns in all market conditions. According to its Anchor Hedge Fund Class A PPM, Class A invested into "a portfolio of well-established independently administered and audited hedge funds to be used to access the [fund's] investment objectives." The PPM also stated that Class A invested into a portfolio of market neutral equity hedge investing and other alternative investments funds, and that Class A would be administered by Folio Administrators, Ltd. The PPM omitted to disclose, however, that Folio was closely affiliated with Battoo and thus was not independent.

In addition to misstatements in written materials, Grossman also orally told Sovereign clients that Class A was a safe fund with an outstanding return and track record over a number of years. Adams also orally told clients in November 2008 that Anchor A was extremely safe and a "good place" to be.

Contrary to Grossman's and Adams' representations, Class A in fact did not invest in independently-administered and audited hedge funds. Grossman knew or was reckless in not knowing that asset verification reports came from parties related to Battoo, not from independent third parties. Indeed, the reports were generated by Anchor Hedge Fund's administrator, based on information provided by the custodian for Battoo and BC Capital. The administrator and custodian were controlled and managed by the same individuals who managed and administered Battoo's

funds and shared the same post office boxes as Anchor Hedge Fund (in fact, they signed the referral and consulting agreements with SIAM, LLC and Grossman).

Grossman also knew that the last independent auditor report Sovereign received for Class A was for the year ended December 31, 2007. Battoo did not provide any other audited financial statements and later told Adams he would not because the information was confidential and proprietary. Yet, Grossman continued to promote Anchor even after he became a consultant to Sovereign.

The investments in Class A were far from diversified. The fund did not invest in what its PPM represented, such as fixed income securities, exchange traded funds, or government and corporate debt. Indeed, many of the funds underlying the Anchor Funds were themselves comprised of other underlying funds. Grossman previously acknowledged that it was possible for the Anchor Funds ultimately to be invested in up to one hundred different funds. In reality, after Battoo suspended redemptions for investments in Class A in December 2008, he claimed Class A had invested substantially all of its assets with Bernard Madoff. The underlying funds were themselves invested in other underlying funds which turned out to be feeder funds into Madoff.[4]

From 2003 until he sold Sovereign, Grossman, along with Battoo, was the sole member of the Class A Investment Advisory Board. As a member of the board and an investment adviser to Sovereign's clients, Grossman knew or was reckless in not knowing that Class A did not invest in funds that were independently administered or audited, or diversified as described in the PPM. Grossman recommended that clients invest (or remain invested) in Class A as late as October 22,

[4] The Division expects the evidence to show that during Grossman's ownership of Sovereign, Battoo periodically provided Grossman with information identifying the funds underlying the Anchor Funds. In some instances, the information Battoo provided was in the form of a pie chart showing the composition of the Anchor Funds and the identity of the underlying funds the Anchor Funds were invested in. Grossman knew that one of these underlying funds was the Galaxy Fund, which was owned by Battoo. As their relationship continued, however, Grossman claimed that despite requests, Battoo eventually ceased providing him with the identity of the underlying funds. Despite this obvious problem, Grossman still continued to promote the Battoo Funds to Sovereign clients.

2008. Adams continued to advise clients to retain their investments in Class A, even after (i) the suspension called into question Battoo's previous representation to Adams that only 2% of the fund had exposure to the Madoff Ponzi scheme; and (ii) Battoo refused to file a proof of claim or provide Adams with supporting documentation of the fund's investments.

c. Liquidity Issues with and Suspension of Anchor Fund Class C

A few months before the Madoff scandal erupted in the press, Anchor Hedge Fund suspended redemptions of Anchor Hedge Fund Class C. On October 13, 2008, Anchor Hedge Fund sent a letter to its Class C shareholders, notifying them that it was suspending redemptions of Class C because it was switching its portfolio from one bank to another. This supposed change began at the end of 2007 but was delayed because of "deteriorating financial market conditions." This letter also stated that Anchor Hedge Fund would "begin processing redemptions as soon as it is practical."

Anchor Hedge Fund misrepresented that its decision to change banks purportedly caused the suspension of redemptions. Indeed, it was Battoo's termination as an adviser from a fund-linked certificate program in which Class C participated that led to the suspension. Grossman continued to advise Sovereign's clients to invest (or retain their investments) in the Battoo Funds. Grossman previously has claimed that he did not know Société Générale had terminated Battoo. However, when Grossman sold Sovereign to Adams in October 2008, Grossman, who was a consultant to Anchor Hedge Fund and a member of its investment advisory board, at a minimum knew that requests for redemptions in Anchor Fund Class C for June 30, 2008 had not yet been honored. In fact, internal Sovereign emails reflect that as of late September 2008 Sovereign was still waiting for redemptions in Class C. Yet, on October 14, 2008, the day after Sovereign was notified of the suspension of redemptions of Class C shares, Grossman described Sovereign's

investments, which included Anchor Hedge Fund, to Sovereign clients as funds that "will experience an incredible bounce. . . . Patience will be rewarded."

After Anchor Hedge Fund suspended redemptions of Class C shares, Adams failed to independently inquire into the suspension. Instead, Adams quickly accepted Battoo's assurances and represented to investors in writing that the suspension was due to Société Générale's failure to timely process a transfer of the custodial relationship for Anchor Fund C. A few weeks after the suspension, Battoo met with Adams and proposed exchanging Class C shares for PIWM shares. Adams accepted Battoo's offer and, without conducting sufficient due diligence on PIWM, recklessly recommended the swap to Sovereign's clients. And Grossman himself continued to recommend PIWM to Sovereign clients at least as late as November 21, 2008.

3. Adams's Misstatements and Omissions Regarding the PIWM Swap

Battoo proposed the swap shortly after Anchor Hedge Fund suspended redemptions of Class C shares. On October 28, 2008, Battoo visited Sovereign's offices and met with Adams. At this meeting, Battoo offered to exchange interests in PIWM's "Market Neutral" managed account for Sovereign clients' investments in shares of Anchor Hedge Fund Classes B, C, and E and in FuturesOne. By October 2008, these classes of Anchor Hedge Fund and FuturesOne had become illiquid or had substantially decreased in value.

Under the terms of the swap, Sovereign investors would receive an interest, or an equivalent value-in-kind participation, in PIWM valued at amounts equal to the pre-impairment values of their hedge fund shares. In exchange, Battoo demanded a lock up period of 18 months.

Because Anchor A was a market neutral fund that had performed well, Adams believed PIWM "Market Neutral" would be the same, and thus he accepted the proposal. He asked for more information about PIWM, but Battoo denied the request, claiming the information was

confidential and proprietary. Had Adams performed even a perfunctory review of PIWM's investments, he would have learned that Battoo managed or controlled almost all of the funds and accounts underlying PIWM, including the funds being exchanged for in the swap. Despite being on PIWM's advisory board since October 2008 and, unbeknownst to clients, being paid by PIWM for referrals, Adams recommended that Sovereign clients swap their Anchor Class C shares for PIWM managed account interests (using the account value of August 31, 2008). Adams also assured clients who invested in Anchor C that the swap was "a generous offer in light of a situation [Battoo] did not create."

In November, 2008, Adams further represented to Sovereign clients that: (i) the suspension of Class C was due to Société Générale's failure to process the transfer of the custodial relationship for Anchor Class C; (ii) PIWM had much a better performance than Class C and, by exchanging the shares, clients would avoid the losses incurred in September and October 2008; and (iii) the resulting shares were subject to an 18 month lock-up. Despite these representations, however, Adams failed to disclose that (i) the underlying investments for PIWM were in other funds almost all managed or controlled by Battoo, including Anchor and FuturesOne, and thus there was no diversification of management style and no reason to expect better performances; (ii) PIWM's sub-funds were illiquid and suspended purportedly due to the Madoff Ponzi scheme (including Anchor Class A and Galaxy Fund) or had incurred such significant losses that the sub-fund was also being exchanged for PIWM (Anchor Class E).

On January 30, 2009, three months after Battoo proposed the swap and almost two months after Battoo had suspended redemptions of Anchor Class A purportedly due to the Madoff scandal, Adams executed an agreement in which AH Nevis transferred to PIWM its shares of Anchor Hedge Fund (all classes except for A) and of FuturesOne. Later, in the fall of 2009, a year after the

swap was proposed by Battoo, Adams was still receiving vague and conflicting responses from Battoo as to the start date of the lock up period and whether it was 18 months or 24 months. Despite this disagreement, Adams continued to advise clients to retain their investments in the Battoo Funds and PIWM.

Beginning in 2010, Battoo refused to redeem the PIWM shares from the swap because of a dispute over the lock-up period and because he claimed Adams had failed to raise additional capital as they had agreed. In November 2011, Battoo publicly claimed to investors that losses incurred in the MF Global bankruptcy caused the suspension of redemptions for PIWM.

C. Grossman and Adams Ignored Red Flags about the Battoo Funds

Prior to the suspension of redemptions in the Battoo Funds and the PIWM swap agreement, Grossman and Adams failed to research adequately or investigate a number of red flags about the Battoo Funds.

First, Grossman knew prior to the October 13, 2008 suspension of redemptions in Anchor Class C shares that Anchor Hedge Fund had not honored redemption requests for the shares submitted in the spring of 2008. Instead of questioning and investigating the failures to redeem and even after Sovereign was notified of the suspension, Grossman continued to recommend Anchor Hedge Fund to clients.

Second, according to Anchor Hedge Fund PPMs, shareholders were entitled to receive annual audited financial reports upon request. However, in 2008 Grossman and Adams knew Battoo had ceased providing to investors independently-audited financial statements regarding the Battoo Funds. In fact, the last independent auditor report Sovereign received from Anchor Hedge Fund for Anchor Class C was for the year ended December 31, 2006, and for Anchor Classes A and B, for the year ended December 31, 2007. Battoo did not provide any other audited financial

statements and told Adams he would not because the information was confidential and proprietary. Nevertheless, Grossman and Adams continued to recommend the Battoo Funds to their clients.

Third, Grossman and Adams knew or were reckless in not knowing that asset verification reports came from parties related to Battoo, not from independent third parties. Anchor Hedge Fund PPMs entitled investors to receive asset verification reports from independent third parties upon request. The reports were generated by Anchor Hedge Fund's administrator, based on information provided by the custodian for Battoo and BC Capital. The administrator and custodian were controlled and managed by the same individuals who managed and administered Battoo's funds and shared the same post office boxes as Anchor Hedge Fund. In addition, these individuals signed the referral and consulting agreements with SIAM, LLC and Grossman. Despite this lack of independence, undisclosed to investors, Grossman and Adams failed to investigate the figures Battoo provided to them. Instead, they touted Battoo's funds to their clients.

Finally, Adams failed independently to investigate Anchor Hedge Fund even after Battoo suspended redemptions of Anchor Class A shares and subsequently refused to file a claim in the Madoff recovery proceedings or provide information regarding the losses.

IV. LEGAL DISCUSSION

A. Grossman and Adams Violated Section 17(a)(2) of the Securities Act

Section 17(a)(2) of the Securities Act makes it unlawful to make any untrue statement of material fact or omit to state material facts in the offer or sale of securities. *Superintendent of Ins. v. Bankers Life and Cas. Co.*, 404 U.S. 6, 10 (1971). Statements and omissions are material if a reasonable investor would consider them important in the total mix of information available. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-232 (1998). To establish a violation of Section 17(a)(2), a finding of scienter is not required. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980). In addition, unlike

Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, Section 17(a) does not concern purchases of securities. Thus, the Division does not need to show that any client or investor actually made any purchases of the Anchor Hedge Funds or PIWM.[5]

Grossman and Adams each obtained money or property by means of material misrepresentations and omissions, in the offer or sale of securities within the meaning of Section 17(a)(2) of the Securities Act. Specifically, Grossman, from late 2003 through late 2008, and Adams, from late 2008 until March 2010, misstated their compensation and failed to disclose conflicts of interest while offering or selling securities in the Battoo Funds and PIWM. They also made false and misleading oral and written statements to investors concerning the safety, diversification, and performance of the investments in the Battoo Funds.

In addition, in recommending the PIWM Swap in November 2008, Adams failed to inform investors that the underlying investments in the PIWM shares included shares that had already suspended redemptions. Among other misstatements, he also told investors that PIWM had much a better performance than Anchor Class C, and by exchanging the shares clients would avoid the losses incurred in September and October 2008. The swap of securities constituted an "offer or sale" of securities because shares of the Anchor classes Sovereign clients owned were sold for interests in PIWM.

B. Grossman and Adams Violated Sections 206(1), 206(2), 206(3), and 207 of the Advisers Act and Aided and Abetted and Caused Violations of Section 206(4) of the Advisers Act and Advisers Act Rules 204-3 and 206(4)-2

Grossman violated the Advisers Act from at least August 2003 through November 2008. Adams violated the Advisers Act from at least October 2008 through August 2010.

[5] In reality, however, as noted above, the overwhelming majority of Sovereign clients actually did purchase the Battoo Funds and PIWM.

1. Sovereign, Grossman, and Adams Were Investment Advisers

Sovereign registered with the Commission as an investment adviser in 2002. Section 202(a)(11) of the Advisers Act defines an "investment adviser" as any person who, for compensation, engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. Sovereign meets this definition because it provided investment advice and received management and performance fees. Grossman and Adams also met this definition and may be charged as primary violators of the Advisers Act's antifraud provisions because they each wholly owned Sovereign, controlled Sovereign, and were in the business of providing investment advice for management and performance compensation. *See In the Matter of John J. Kenny and Nicholson/Kenny Capital Management, Inc.*, Advisers Act Release No. 2128 at n. 54 (May 14, 2003) ("An associated person may be charged as a primary violator under Section 206 where the activities of the associated person cause him or her to meet the broad definition of an 'investment adviser.'") (citing, as examples, *SEC v. Berger*, 244 F. Supp. 2d 180, 193 (S.D.N.Y. 2001) (finding associated person liable under Sections 206(1) and 206 (2) based on control of investment adviser); *SEC v. Gotchey*, 981 F.2d 1251 (4th Cir. 1992) (finding president and half-owner of investment adviser liable under Sections 206(1) and 206(2)).

2. Grossman and Adams Violated Sections 206(1) and 206(2) of the Advisers Act

Sections 206(1) and 206(2) of the Advisers Act prohibit an investment adviser from employing any device, scheme, or artifice to defraud or from engaging in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. These sections impose a fiduciary duty on an investment adviser with respect to its clients. *Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 17 (1979); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 189-92 (1963). This broad duty is not limited to activity in the offer or sale, or

in connection with the purchase or sale, of any security, but reflects the fiduciary nature of an adviser's relationship with his clients. *Laird v. Integrated Resources, Inc.*, 897 F.2d 826, 833 (5th Cir. 1990); *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985) (citing *Capital Gains*, 375 U.S. at 194 and n.44).

An investment adviser has an affirmative obligation of utmost good faith and full and fair disclosure of all material facts, including any material conflicts of interest, and must employ reasonable care to avoid misleading clients and prospective clients. *Capital Gains*, 375 U.S. at 194-95. An investment adviser is prohibited from using its clients' assets to benefit itself. *Id.* Sections 206(1) and (2) apply to all investment advisers, not just to those who are registered. *See In the Matter of John J. Kenny*, Advisers Act Release No. 2128 (May 14, 2003) at n. 54.

Knowing or extreme reckless conduct is required to establish a violation of Section 206(1). *SEC v. K.W. Brown and Co.*, 555 F. Supp. 2d 1275, 1308 (S.D. Fla. 2007) ("The scienter requirement under Section 206(1) has been defined by the general standards utilized under the antifraud provisions of the Securities Act and the Exchange Act."). Extreme recklessness can be shown by "red flags," "suspicious events creating reasons for doubt," or "a danger . . . so obvious that the actor must have been aware of" the danger of violations. *Id.* at 1307. Only negligence is required to establish a violation of Section 206(2). *Steadman v. SEC*, 603 F.2d 1126, 1134-35 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *SEC v. Mannion*, 789 F. Supp. 2d 1321, 1339 (N.D. Ga. 2011).

a. Misrepresentations and Omissions by Grossman and Adams

Section 206 implicitly contains a materiality requirement. *Capital Gains*, 375 U.S. at 194 & n.44. Materiality is established if a reasonable investor would have considered the misrepresented or omitted fact important when deciding whether to buy, sell, or hold the security

in question. *See Basic*, 485 U.S. at 231-32. The existence of a potential conflict of interest is a material fact that an investment adviser must disclose to its clients. *Capital Gains*, 375 U.S. at 191-92; *Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003) (stating that "[i]t is indisputable that potential conflicts of interest are 'material' facts with respect to clients"). Such a conflict exists when an adviser receives undisclosed outside compensation. *In re IMS/CPAs & Associates, et al.*, Advisers Act Release No. 1994 (Nov. 5, 2001).

i. Failure to disclose compensation received in exchange for referring clients to the Battoo Funds and PIWM

As described above, Grossman and Adams each recommended the Battoo Funds and PIWM to clients in exchange for substantial referral fees from Battoo, which Grossman received until approximately late 2008 and Adams until August 2010. Receiving compensation from Battoo created conflicts of interest between Grossman, Adams, and their clients. As investment advisers, Grossman and Adams had obligations to put their clients' interests ahead of their own. In breach of their obligations, they used client assets to benefit themselves financially and compromised their ability to evaluate independently whether to recommend, or to keep, the Battoo Funds and PIWM as investments for their clients. Grossman and Adams failed to disclose this conflict and recommended almost exclusively that clients invest, or stay invested, with the Battoo Funds and PIWM. In fact, the fees that Grossman and Adams solicited were contrary to disclosures made to clients about their compensation, such as in Sovereign's Form ADV Part II, including statements that clients would be notified of "any and all fees" paid to their advisers. By intentionally not disclosing their arrangements with Battoo in breach of their fiduciary duties, Grossman and Adams violated Sections 206(1) and 206(2).[6]

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[6] Grossman previously has taken the position that use of the phrase "***may*** receive performance-based compensation" in the 2006 revision to the IAA and in Sovereign's Form ADV filings satisfied his disclosure obligations to clients. Aside from the fact that, as noted in the text above, the IAA and ADV also said that

ii. Grossman's material omissions and misstatements regarding Anchor Hedge Funds

As a member of Anchor Hedge Fund's Investment Advisory Board, Grossman knew, or was reckless in not knowing, material facts about the performance of Anchor Hedge Fund:

- Grossman advised his clients to invest in Anchor Classes A and B without disclosing their exposure to high risk Anchor Class C. The cross portfolio structure, however, was disclosed in the independent auditor reports for Anchor Classes A, B, and C that Grossman received;

- Grossman promoted Anchor Class A to clients and prospective clients as a diversified fund with a portfolio of well-established, independently-administered and audited hedge funds. In fact, that was not true; and

- Although Anchor Class C had lost access to the one program it invested in and was not timely honoring redemption requests (and redemptions were suspended), Grossman continued to recommend clients keep Anchor Class C and promoted the safety of the Battoo Funds.

Given Grossman's advisory role in Anchor Hedge Fund, his representations to clients of his active involvement with Anchor Hedge Fund, and his fiduciary duties as an investment adviser, his purported lack of knowledge of these critical issues at the very least constitutes severe recklessness in breach of his fiduciary duties to his clients.

iii. Adams's material omissions regarding the PIWM Swap

Adams recommended to clients that they exchange their investments in Anchor Hedge Fund Classes B, C, and E and in FuturesOne for interests in PIWM. Among other things, he failed to disclose that the underlying PIWM investments were to other funds and accounts Battoo managed or controlled and included the same funds being exchanged for PIWM.

Sovereign would notify clients of "any and all fees" paid to Sovereign, which Grossman never did, the use of the word "may" is still misleading where, as here, compensation actually was being paid. This is akin to a "half-truth," which is a statement that is literally true, but when considered in context, is materially misleading. *See, e.g.*, *Blavin*, 760 F.2d at 711; *SEC v. Gabelli*, 653 F.3d 49, 57 (2d Cir. 2011), *rev'd on other grounds*, 133 S. Ct. 1216 (2013); *SEC v. Radius Cap. Corp.*, No. 11-cv-116-29DNF, 2012 U.S. Dist. LEXIS 26648, at *19-20 (M.D. Fla. Mar. 1, 2012); *SEC v. Corporate Relations Group, Inc.*, No. 99-cv-1222, 2003 U.S. Dist. LEXIS 24925, at *27-28 (M.D. Fla. Mar. 28, 2003; *In re Daniel R. Lehl*, Release No. 8102, 77 S.E.C. Docket 1926, 2002 WL 1315552, at *11 (2002).

b. Failure to Perform Due Diligence and Investigate Red Flags

Grossman and Adams also violated Sections 206(1) and 206(2) when they ignored obvious red flags while continuing to reap fees from clients and compensation from Battoo. For example, despite knowing Anchor Hedge Fund had not honored redemption requests for Class C shares submitted in the spring of 2008, Grossman continued to recommend Anchor Hedge Fund. And both he and Adams knew Battoo had ceased providing independently-audited financial statements regarding the Battoo Funds. Yet, Grossman and Adams continued to recommend Battoo's funds to Sovereign clients. Their conduct, in light of their duties and obligations as investment advisers, was severely reckless. *SEC v. GLT Dain Rauscher*, 254 F.3d 852, 858 (9th Cir. 2011) (securities professional has "a duty to make an investigation that would provide him with a reasonable basis for a belief that the key representations in the statements provided to the investors were truthful and complete"); *SEC v. Blavin*, 557 F. Supp. 1304, 1314 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985) (investment adviser has "a duty to his clients and readers to undertake some reasonable investigation of the figures he was printing before he printed them. Certainly, a reader of an investment newsletter has the right to expect the investment adviser to do more than merely reprint (and in this case totally out of context and selectively) glowing financial news gleaned from financial reports or conversations with companies or officers").

Red flags give rise to a securities professional's duty to investigate those flags, and ignoring red flags is reckless. *Blavin*, 760 F.2d at 711-12 (as a fiduciary, the standard of care to which an investment adviser must adhere imposes "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation to 'employ reasonable care to avoid misleading' his clients.") (citations omitted); *In the Matter of Alfred C. Rizzo*, Advisers Act Release No. 897, 1984 SEC LEXIS 2429, *7 (Jan. 11, 1984) (finding

investment adviser violated Section 206 where he made misstatements and omissions after failing to verify information received from management that formed the basis for his investment advice); *In the Matter of Performance Analytics, Inc., and Robert P. Moseson*, Advisers Act Release No. 1978 (Sept. 27, 2001) (finding investment adviser violated Section 206(2) where he "should have known" that information provided by a money manager that he recommended to his clients was inaccurate); *see also SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 9 (D.D.C. 1998) (failure to disclose lack of due diligence is a material omission); *In the Matter of Hennessee Group LLC*, Advisers Act Release No. 2871 (Apr. 22, 2009) (investment adviser owes fiduciary duty to conduct due diligence as represented).

3. Grossman and Adams Violated Section 206(3) of the Advisers Act

Section 206(3) of the Advisers Act provides that it is unlawful for any investment adviser to an advisory client acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.

Section 206(3) does not require a showing of scienter. *In the Matter of Marc N. Geman*, Advisers Act Release No. 34-43963, 2001 WL 124847 *8 (Feb. 14, 2001). The disclosure must be sufficient to identify "the potential conflicts of interest and terms of a transaction." *Interpretation of Section 206(3) of the Investment Advisers Act of 1940*, Advisers Act Release No. 1732, 67 S.E.C. Docket 1344, 1998 WL 400409 (July 17, 1998). In general, the transaction-based compensation received by the investment adviser, among other things, should be disclosed. *See id.*

During their respective periods of ownership, Grossman and Adams each was the sole or

majority owner of Sovereign, AH Florida, AH Nevis, and SIAM, LLC. Each received transaction-based compensation, through SIAM, LLC, from the Battoo-related entities for purchases of the Battoo Funds and PIWM. Grossman and Adams violated Section 206(3) when, as investment advisers, they knowingly effected the sale of the Battoo Funds and PIWM to their clients without (i) providing adequate written disclosures to clients that they were acting as brokers for the Battoo Funds and PIWM; and (ii) obtaining the requisite client consent. *See* Interpretation of § 206(3) of the Advisers Act, Advisers Act Release No. 1732, 1998 WL 400409 (July 17, 1998).

4. Grossman and Adams Aided and Abetted and Caused Violations of Section 206(4) of the Advisers Act and Advisers Act Rule 206(4)-2

Section 206(4) of the Advisers Act prohibits an investment adviser from, directly or indirectly, engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. Scienter is not required to establish a violation of Section 206(4). *Steadman*, 967 F.2d at 647; *see also Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, Advisers Act Release No. 2628 (Aug. 3, 2007), 72 FR 44576 (2007).

Rule 206(4)-2 requires registered investment advisers that maintain custody of client funds to adequately safeguard and account for client assets by implementing specific procedures.[7] Under the rule, a registered investment adviser that has custody of client assets must either undergo a surprise annual examination by an independent public accountant or have the fund's audited financial statement distributed to investors. *See, e.g.*, *Custody of Funds or Securities of Clients by Investment Advisers*, Advisers Act Release No. 2176 (Sept. 25, 2003). Rule 206(4)-2(c)(1) defines custody as "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them." Custody is further defined to include "[a]ny arrangement (including a

[7] The Commission amended Advisers Act Rule 206(4)-2 effective March 12, 2010. *See* Advisers Act Release No. 2968 (Dec. 30, 2009). Although the Rule has been amended several times since Sovereign's inception, the requirements at issue were in effect throughout the course of the conduct described here.

general power of attorney) under which [the registered investment adviser is] authorized or permitted to withdraw client funds or securities maintained with a custodian upon [the adviser's] instruction to the custodian." Rule 206(4)-2(c)(1)(ii).

To establish aiding and abetting liability, the Commission must show: (i) a primary violation; (ii) the aider and abettor provided "substantial assistance" to the violator; and (iii) the aider and abettor acted with scienter. *SEC v. BIH Corp.*, 2011 U.S. Dist. LEXIS 97821 (S.D. Fla. Aug. 31, 2011). The knowledge requirement can be satisfied by extreme recklessness, which can be shown by "red flags," "suspicious events creating reasons for doubt," or "a danger . . . so obvious that the actor must have been aware of" the danger of violations. *K.W. Brown*, 555 F. Supp. 2d at 1307. Additionally, "[a] finding that a respondent willfully aided and abetted violations of the securities laws necessarily makes that respondent a 'cause' of those violations." *In the Matter of M.A.G. Capital LLC and David Firestone*, Advisers Act Release No. 2849 (March 2, 2009).

Here, from 2005 until October 2008, Sovereign, through Grossman, its owner and control person, and from October 2008 until August 2010, through Adams, its owner and control person, pooled its clients' funds in AH Florida's bank account at EverBank prior to transferring them offshore to the Battoo Funds and PIWM. As a result, Sovereign, through Grossman and Adams, had custody of client funds and was required to send quarterly account statements to clients, either from itself or through a qualified custodian. *See generally* Rule 206(4)-2(a)(3). If Sovereign sent them, Sovereign was then subject to a surprise annual examination conducted by an independent public accountant (*see generally* Rule 206(4)-2(a)(3)(ii)(B)). By March 2010, a surprise annual audit was required of all investment advisers that had custody of client funds. *See* Rule 206(4)-2(a)(4). Here, clients received no statements from qualified custodians or Sovereign regarding

their monies invested through AH Florida. Although Sovereign sent statements to clients regarding their purported investments in the Battoo Funds, there were no surprise annual exams of Sovereign during the relevant period. Accordingly, Sovereign violated Rule 206(4)-2 and Grossman and Adams aided and abetted and caused that violation.

5. Grossman and Adams Violated Section 207 of the Advisers Act

Advisers Act Section 207 makes it unlawful "for any person willfully to make any untrue statements of material fact in any registration application or report filed with the Commission under Section 203 or 204." Section 207 does not require a finding of scienter; it merely requires willfulness. *K.W. Brown*, 555 F. Supp. 2d at 1309 ("[a] finding of willfulness does not require intent to violate (or scienter), but merely intent to do the act which constitutes the violation.").

Here, as described above, Sovereign's Form ADV Parts 1 and II contained material misstatements and omissions. Sovereign did not disclose any possible compensation in Part 1 until April 6, 2009. In its March 28, 2006 Form ADV Part II, for the first time Sovereign stated that it "may receive incentive or subscription fees from certain investment companies. [Sovereign] may receive performance-based compensation from certain investment companies. [Sovereign] will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to [Sovereign]." As described above, however, Grossman and Adams never notified Sovereign clients of any fees. And Part II of the ADV never mentioned any referral fees or transaction-based compensation despite containing a specific box, which was never checked, to disclose receipt of "some economic benefit from a non-client in connection with giving advice to clients." Grossman (from 2003 through 2008) and Adams (in 2009 and 2010) signed Sovereign's Form ADV which contained material omissions and misstatements concerning, among other things, compensation and conflicts of interest.

Accordingly, Grossman and Adams violated Section 207 of the Advisers Act. *See SEC v. Alfred Clay Ludlum III, et al.*, Civil Action No. 10 7379 (E.D. Pa. Dec. 17, 2010) (registered investment adviser's untrue statements of material fact and willful omissions of material fact in a Form ADV constituted a violation of Advisers Act Section 207); *see also In the Matter of Oakwood Counselors, Inc.*, Advisers Act Release No. 1614 (Feb. 10, 1997) (settled order finding adviser and adviser's president, who signed false Form ADVs, violated Section 207).

6. Grossman and Adams Aided and Abetted and Caused Violations of Advisers Act Rule 204-3

An investment adviser registered or required to be registered with the SEC "must deliver a brochure and one or more brochure supplements to each client or prospective client that contains all information required by Part II of Form ADV." In this case, Sovereign did not timely provide a brochure to each client or prospective client containing all information required by the Form ADV Part II. For the reasons described above, Grossman and Adams, while each owned and controlled Sovereign, aided and abetted and caused these violations.

C. Grossman and Adams Violated and Aided and Abetted and Caused Violations of Section 15(a) of the Exchange Act

Section 15(a)(1) of the Exchange Act prohibits any broker or dealer to make use of the mails or any means of interstate commerce to effect any transactions in, or induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is: (i) registered with the Commission; (ii) in the case of a natural person, is an associated person of a registered broker-dealer; or (iii) satisfies the conditions of an exemption or safe harbor. A showing of scienter is not required to establish a violation of Section 15(a). *See, e.g., SEC v. United Monetary Servs., Inc.*, No. 83-8540-CIV, 1990 WL 918812, at *8 (S.D. Fla. May 18, 1990).

Section 3(a)(4)(A) of the Exchange Act defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." Among the factors considered in determining whether a person may be a broker include whether the person: "(1) actively solicited investors; (2) advised investors as to the merits of an investment; (3) acted with a 'certain regularity of participation in securities transactions'; and (4) received commissions or transaction-based remuneration." *SEC v. U.S. Pension Trust Corp.*, Case No. 07-22570, 2010 WL 3894082, at *21 (S.D. Fla. Sept. 30, 2010) (citations omitted), *aff'd*, 444 Fed. Appx. 435 (11th Cir. Oct. 26, 2011).

Here, Grossman and Adams willfully violated Section 15(a) of the Exchange Act by acting as brokers while not registered as such with the Commission and while not associated persons of a broker or dealer registered with the Commission. Indeed, Grossman and Adams offered and sold security interests in the Battoo Funds and PIWM. In return for their promotion and sales, Grossman and Adams received transaction-based compensation from the Battoo Funds and PIWM in the form of referral fees (pursuant to three written referral agreements and an oral referral agreement) for each investor that invested in the Battoo Funds and PIWM. By acting as unregistered broker-dealers in offering the Battoo Funds and PIWM, they each violated Section 15(a) of the Exchange Act. Moreover, Grossman and Adams aided and abetted and caused Sovereign's and SIAM, LLC's violations.

D. <u>Respondents' Affirmative Defenses</u>

1. Grossman

In his Answer to the OIP, Grossman originally pleaded seven affirmative defenses, but in response to the Division's Motion to Strike filed on January 6, 2014, he withdrew all but two of the defenses (statute of limitations and estoppel).

At the prehearing conference held on March 7, 2014, the Law Judge postponed ruling on the statute of limitations defense until after the final hearing in this matter, but struck the defense of estoppel as improper.

The Division notes that Grossman's statute of limitations defense is substantively without merit. First, even assuming that some of Grossman's misconduct falls outside the five-year statute of limitations period set forth in 28 U.S.C. § 2462, the same would impact ***only*** the Division's claim for a civil penalty, not its claims for disgorgement, prejudgment interest or a cease-and-desist order. *See, e.g., In re Carley et al.*, File No. 3-11626, 2008 SEC LEXIS 222, at *87 (Jan. 31, 2008) (cease-and-desist orders and disgorgement not subject to the limitations period in 28 U.S.C. § 2462 because they are not "punitive measures"); *US v. US Steel*, No. 12-cv-304, 2013 U.S. Dist. LEXIS 118513, at *28 (N.D. Ind. Aug. 21, 2013) (injunctive relief not subject to 28 U.S.C. § 2462 because it is remedial); *SEC v. Wyly*, No. 10-cv-5760, 2013 U.S. Dist. LEXIS 80727, at *28 (S.D.N.Y. June 6, 2013) (primary purpose of injunctive relief is not to penalize but to protect against future harm); *SEC v. Wall Street Commn's, Inc.*, No. 09-cv-1046, 2010 U.S. Dist. LEXIS 80337, at *16 (M.D. Fla. Aug. 10, 2010) (equitable remedies not governed by 28 U.S.C. § 2462).[8]

Second, the Division will introduce evidence that Grossman's conduct falls within the limitations period. Indeed, Grossman himself continued to recommend investments in PIWM as late as November 21, 2008, which would fall within the five-year statute of limitations period.

Third, any of Grossman's misconduct that predates the limitations period may be viewed as part of a continuing, interrelated scheme to defraud investors, particularly after the sale of Sovereign to Adams, which would satisfy the "continuing violation" exception to the statute of

[8] Contrary to Grossman's position, the Supreme Court's ruling in *Gabelli* has not changed any of these longstanding principles. As the Law Judge is aware, *Gabelli* addressed the limited issue of whether the discovery rule serves to toll the 5-year statute of limitations applicable to civil penalties under 28 U.S.C. § 2462. *See Gabelli*, 133 S. Ct. at 1219. No other issue was before the Court, and the Court even confirmed this by noting in dicta that application of 28 U.S.C. § 2462 to injunctive relief and disgorgement was not decided. *See id.* at 1220 n.1.

limitations. *See In re Simpson et al.*, File No. 3-9458, 1999 SEC LEXIS 1908, at * 116-17 (Sept. 21, 1999). Moreover, the Law Judge correctly observed at the prehearing conference on March 7, 2014 that evidence of Grossman's misconduct that may fall outside of the period is still admissible in this proceeding and relevant for purposes of the sanctions to be imposed. *See id.*; *see also In re Carley et al.*, 2008 SEC LEXIS at * 86-87.

Grossman's estoppel defense is based on an examination of Sovereign in 2004 by the Commission's Office of Compliance, Inspections and Examinations ("OCIE"). Following the examination, OCIE identified numerous deficiencies, including the fact that Grossman and Sovereign did not properly disclose the compensation they received from Battoo under the agreements. Grossman claims that in its deficiency letter, OCIE "recommended how Sovereign could correct such deficiencies" and that Sovereign followed the recommendations. Grossman then alleges after OCIE took no further action, he believed the matters were resolved and relied on that accordingly. He contends therefore that the Division is estopped from proceeding with its claims in this case either (i) because of OCIE's inaction following the exam; or (ii) because OCIE misrepresented the corrective action Grossman needed to take. Neither iteration of this argument, however, is valid.

First, as the Law Judge correctly ruled at the prehearing conference on March 7, 2014, it is well settled that the United States government and its agencies may not be estopped on the same terms as other litigants and may not waive the requirements of the federal laws the agencies are tasked with enforcing. *See, e.g., SEC v. Keating*, 1992 WL 207918, *3 (C.D. Cal. July 23, 1992) ("In the context of a civil enforcement action by the SEC, courts have flatly rejected the estoppel defense for the reason that the Commission may not waive the requirements of an act of Congress nor may the doctrine of estoppel be invoked against the Commission."). If the estoppel defense

has any viability to claims brought by the federal government, it is "only in the most extreme circumstances." *Dantran, Inc. v. United States Dept. of Labor*, 171 F.3d 58, 66 (1st Cir. 1999), *rev'd on other grounds*, 246 F.3d 36 (1st Cir. 2001). At the very least, "the defendant must prove that the government's conduct was egregious and that the resulting prejudice to the defendant was of a constitutional magnitude." *SEC v. McCaskey*, 56 F. Supp. 2d 323, 326 (S.D.N.Y. 1999); *see also Office of Personnel Mgt. v. Richmond*, 496 U.S. 414 (1990) (noting that the Courts of Appeal have searched for "an appropriate case in which to apply estoppel against the Government, yet we have reversed every finding of estoppel that we have reviewed"). Here, there is simply no evidence to suggest this proceeding qualifies as an extreme circumstance where the Commission's conduct was egregious, nor is there any evidence showing that Grossman's constitutional rights were violated.

Second, Law Judges have already rejected the argument that the Division's claims may be barred as a result of a respondent's putative reliance on OCIE's alleged inaction following an examination. *See, e.g., Newbridge Securities Corp. et al.*, File No. 3-13099, 2009 SEC LEXIS 2058, at *167-68 (June 2, 2009) (rejecting respondents' argument that OCIE's inaction following respondents' response to the deficiency letter was a tacit approval of respondents' proposed correction of the deficiency, and holding that "it is well settled that respondents cannot shift responsibility for compliance to the NASD or the Commission"); *William H. Gerhauser*, File No. 3-9519, 53 S.E.C. 933, 940 (Nov. 4, 1998) ("[A] regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation"); *Steven C. Pruette*, File No. 3-5108, 46 S.E.C. 1138, 1141 (1978) (same).

And third, to survive a motion to strike an estoppel defense in an administrative proceeding, a respondent must plead, and show that he or she eventually can prove, a "definite

misrepresentation of fact to another person." *In re Alderman et al.*, No. 3-15127, 2013 SEC LEXIS 351, at *13 (Feb. 1, 2013). Grossman does not allege anywhere in his Answer any "definite" or specific representation that he claims OCIE staff made to him and that he in turn relied on. Instead, he claims generally that the staff "recommended how Sovereign could correct [the] deficiencies" and that he "followed the staff's recommendations." (Grossman Answer, at 10.) But he fails to identify any specific representation or recommendation that he claims OCIE made. This is fatal to his estoppel defense as a matter of law, and the Law Judge therefore should strike it. *See In re Alderman et al.*, 2013 SEC LEXIS at *16 (holding that respondent could not prove a "definite misrepresentation" and granting the Division's motion to strike the estoppel defense). Accordingly, the Law Judge should reject Grossman's estoppel defense.

2. Adams

As noted above, at the prehearing conference held on March 7, 2014, the Law Judge stayed the case against Adams in order to allow the Commission an opportunity to consider his offer of settlement. In the event the settlement is not approved, the Division summarizes the following arguments from its Motion to Strike Adams' Affirmative Defenses as to why Adams' affirmative defenses should be rejected:

In his first affirmative defense, Adams alleges that "[t]here is no basis to support a cease and desist order against either [sic] Mr. Adams." (Adams Answer, at 15.) Aside from the conclusory nature of the defense described in the Motion to Strike, this defense also is improper because it is a mere denial of the Division's entitlement to relief. In *In re Park Financial Group, Inc. et al.*, File No. 3-12614 (Jul. 19, 2007), the respondent asserted exactly the same defense as Adams has raised here – *i.e.*, "[t]here is no basis for a cease-and-desist order against Cantley or Park as there is no risk of future violations." *Id.* at 2. In striking the defense, the Law Judge in

Park Financial held very clearly that "[c]hallenging the Division's ability to prove entitlement to relief does not meet the definition of an affirmative defense" because it does not assert a "new matter that eliminates or limits the [respondent's] ordinary liability." *Id.* at 3. Accordingly, the Law Judge should reject this defense.[9]

Adams' second affirmative defense states: "The Commission has failed to state a claim upon which relief may be granted." (Adams Answer, at 15.) As noted in the Motion to Strike, a failure-to-state-a-claim defense must provide "allegations as to how [p]laintiff has failed to state a claim" especially where, as here, more than one claim has been asserted against Adams. *See EEOC v. SVT, LLC*, 2013 U.S. Dist. Lexis 161989, at*3 (N.D. Ind. Nov. 14, 2013). Adams made no such allegations in his Answer, and the Law Judge therefore should reject the second defense.

Lastly, Adams' third and fourth affirmative defenses are properly rejected because, as with the first defense, they merely rebut components of the Division's case rather than asserting new matters. Specifically, Adams alleges in his third defense that he "has not misled any Sovereign investors at any time" and in his fourth defense, he alleges that he "has not made any material misrepresentations or omissions, in writing or otherwise." Because these defenses only deny liability, they are not proper affirmative defenses, and the Law Judge should reject them. Again, this will not affect Adams' ability to raise these issues at the hearing, since they are elements the Division must prove as part of its *prima facie* case. Adams will have the ability to argue the Division cannot prove these elements without these superfluous and improper affirmative defenses.[10]

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[9] Assuming the Commission does not approve Adams' offer of settlement, Adams would then be able to present evidence that the Commission has not established a prima facie case on its claims. But this does not justify assertion of the affirmative defense he has raised.

[10] Adams voluntarily withdrew his fifth defense after the Division filed its Motion to Strike. That defense was merely a reservation of the right to assert additional defenses.

V. REMEDIES

A. Disgorgement and Civil Penalties Are Appropriate

Pursuant to Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act, the Commission may (i) enter an order requiring disgorgement from a respondent, including reasonable interest; and (ii) impose a civil penalty if the respondent has wilfully[11] violated, or aided or abetted a violation of, any provision of the Securities Act, Exchange Act, Advisers Act or the Investment Company Act, and a penalty is in the public interest.

1. Disgorgement

As discussed above, the facts at the final hearing will show Grossman and Adams violated the federal securities laws. The facts also will show that Grossman and Adams profited from their illegal conduct in the respective amounts of $3.3 million and $1 million in compensation and fees under the various referral agreements with Battoo. These payments were made through SIAM, LLC's bank account at Jyske Bank in Denmark. Under the circumstances, it would be inequitable to allow Grossman and Adams to keep that money

Disgorgement is designed both to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws. *See SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989); *Blavin*, 760 F.2d at 713; *SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987), *cert. denied*, 486 U.S. 1014 (1988); *SEC v. Manor Nursing Centers*, 458 F.2d 1082, 1104 (2d Cir. 1972) ("The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable"). Where, as

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[11] In this context, "wilfully" means that a respondent intended only to do the underlying acts that constituted the violations, not that he knew he was or violating or intended to violate the law. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating the securities laws.

here, the fraud is "pervasive," the Law Judge should order all profits stemming from the scheme to be disgorged. *CFTC v. British American Commodity Options Corp.*, 788 F.2d 92, 93-94 (2d Cir. 1986), *cert. denied*, 479 U.S. 853 (1986). Courts are empowered to order wrongdoers to disgorge the amount of their profits from the wrongdoing. *SEC v. ETS Payphones, Inc.,* 408 F.3d 727, 735 (11th Cir. 2005). "The district court has broad discretion not only in determining whether or not to order disgorgement but also in calculating the amount to be disgorged." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474-75 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997).

The Commission is entitled to disgorgement "upon producing a reasonable approximation of a defendant's ill-gotten gains." *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004). The Commission's burden for showing "the amount of assets subject to disgorgement . . . is light . . . Exactitude is not a requirement.'" *ETS Payphones*, 408 F.3d at 735. Once the Division presents evidence reasonably approximating the amount of a respondent's ill-gotten gains, the burden of proof on the amount the respondent received shifts to the respondent. *First City*, 890 F.2d at 1232; *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1085 (D. N.J. 1996), *aff'd* 124 F.3d 449 (3rd Cir. 1997). The respondent is then "obliged clearly to demonstrate that the disgorgement figure [is] not a reasonable approximation." *First City*, 890 F.2d at 1232.

The Division will present evidence at the final hearing demonstrating that Grossman and Adams received ill-gotten gains in the form of fees and compensation from Battoo. Given the pervasiveness of the fraud and the blatant failure to disclose this compensation to Sovereign clients, the Law Judge should order disgorgement in the full amounts of the compensation that Grossman and Adams received.

In addition to disgorgement, prejudgment interest is equitable in these circumstances. The Respondents have enjoyed access to their ill-gotten gains over a period of time. To require

payment of prejudgment interest is consistent with the equitable purpose of the remedy of disgorgement. *Hughes Capital*, 917 F. Supp. at 1090. Prejudgment interest should be calculated in accordance with the delinquent tax rate established by the Internal Revenue Service, 26 U.S.C. § 6621(a)(2), and assessed on a quarterly basis, from November 21, 2008 to the date judgment is entered, for Grossman, and from August 31, 2010 to the date judgment is entered, for Adams. The rate of interest "reflects what it would have cost to borrow money from the government and therefore reasonably approximates one of the benefits the defendant received." *First Jersey*, 101 F. 3d at 1476.

2. Civil Penalties

Civil penalties are designed to punish the violator and deter future violations of the securities laws. *SEC v. Palmisano,* 135 F.3d 860, 866 (2nd Cir. 1998); *SEC v. K.W. Brown*, 555 F. Supp. 2d at 1314 (S.D. Fla. 2007); *SEC v. Tanner,* Case No. 02-0306, 2003 WL 21523978 at *2 (S.D.N.Y. July 3, 2003); *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. at 17 (D.D.C. 1998); *SEC v. Moran,* 944 F. Supp. 286, 296 (S.D.N.Y. 1996). As set forth in H.R. Report No. 616 - the Report of the Committee on Energy and Commerce of the U.S. House of Representatives on the Remedy Act,

> [T]he money penalties proposed in this legislation are needed to provide financial disincentives to securities law violations other than insider trading ... Disgorgement merely requires the return of wrongfully obtained profits; it does not result in any actual economic penalty or act as a financial disincentive to engage in securities fraud .... The Committee therefore concluded that authority to seek or impose substantial money penalties, in addition to the disgorgement of profits, is necessary for the deterrence of securities law violations that otherwise may provide great financial returns to the violator. (Citations omitted).

1990 WL 256464 *20, 1990 U.S.C.C.A.N. 1379 *1384 (Leg. Hist.), H.R. Rep. 101-616, H.R. Rep. No. 616, 101st Cong., 2nd Sess. 1990.

Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act establish the same three-tier system of penalties:

Under the first tier, the Court may impose a penalty of up to the greater of: (i) $7,500 for a natural person or $75,000 on an entity for each violation; or (ii) the gross amount of pecuniary gain to the defendant as a result of the violation. Under the Second Tier, the Court may impose a penalty of up to the greater of: (i) $75,000 for a natural person or $375,000 on an entity for each violation; or (ii) the gross amount of pecuniary gain to the defendant as a result of the violation. The second tier applies where the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. Finally, under the third tier the Court may impose a penalty of up to the greater of: (i) $150,000 on a natural person or $725,000 on an entity for each violation; or (ii) the gross amount of pecuniary gain to the defendant as a result of the violation. *SEC v. KS Advisors, Inc.*, No. 2:04-CV-105-FTM-29, 2006 WL 288227 at *3 (M.D. Fla. Feb. 6, 2006). The third tier applies to cases in which the requirements of a second tier penalty are present *and* the violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons. *Meadows v. SEC*, 119 F.3d 1219, 1228 (5th Cir. 1997). Because of the circumstances in this case, including the fact that the overwhelming majority of Sovereign investors were invested in the Battoo Funds and PIWM and sustained significant losses of their investments, the Law Judge should impose third-tier civil penalties against Grossman and Adams.[12]

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[12] Under the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, these amounts were adjusted to account for inflation, based on violation dates. 17 C.F.R. §§ 201.1001-1004, Tbl. II-IV to Subpt. E. The adjusted rates apply to Adams because his fraudulent conduct occurred after the adjustment date of March 3, 2009. *See* 17 C.F.R. § 201.1004, Tbl. IV to Subpt. For Grossman, the prior rates before the adjustment date would apply. For the third tier, Grossman, as a natural person, would be subject to a penalty in the greater of: (i) $130,000

Courts have determined that a violation occurs each time a respondent has acted to violate the securities laws. *See SEC v. Lazare Indus., Inc.*, 294 Fed. Appx. 711, 715 (3rd Cir. 2008) (for the purposes of assessing reasonableness of district court's assessment of $500,000 penalty, court considered each sale of unregistered stock as a separate violation); *SEC v. Coates*, 137 F. Supp. 2d 413, 430 (S.D.N.Y. 2001) (court calculated penalty by multiplying number of misrepresentations by penalty amount). Therefore, the Law Judge could impose a penalty of $130,000 on Grossman and $150,000 on Adams for ***each*** violation that occurred in this case.

Factors to consider when assessing a civil penalty include the egregiousness of the violation, the isolated or repeated nature of the violations, the degree of scienter involved and the deterrent effect given the defendant's financial worth. *K.W. Brown*, 555 F. Supp. 2d at 1315; *SEC v. Yun,* 148 F. Supp. 2d 1287 (M.D. Fla. 2001). Application of these factors to Grossman and Adams merits a high penalty for both. As discussed above, their conduct was egregious and recurrent, and both demonstrated a high degree of scienter. Moreover, based upon the public policy objective of deterrence, the Division submits a substantial penalty is necessary and appropriate to punish the Respondents for their unlawful activities and deter others from engaging in violations of the federal securities laws. Indeed, a monetary penalty also would deter Grossman, Adams and others from similar conduct in defiance of the basic principles of full and fair disclosure and avoidance of conflicts of interest that are at the heart of the securities laws. *See In The Matter Of Piper Capital Management, Inc., et al.*, 80 SEC Docket 2772, 2003 WL 22016298 at *22 (August 26, 2003) ("[a]s the law judge properly noted, a monetary penalty serves to deter other persons and entities in the securities industry from committing in the future the violations [respondent] committed in this case."). Given Grossman's and Adams' efforts to conceal their

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for each violation he committed; or (ii) the gross amount of pecuniary gain to Grossman as a result of the violation.

compensation from Sovereign investors, and their disregard of obvious warnings signs that should never have led them to recommend the Battoo Funds and PIWM in the first place, a third-tier penalty is appropriate.

B. Cease-and-Desist Orders are Appropriate

Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act empower the Commission to order a person who has been found, after notice and hearing, to have violated or caused any violation of those Acts, to cease and desist from committing or causing such violations and any future violations.

The factors for considering whether a cease-and-desist order is warranted are very similar to the factors set forth in *Steadman*, 603 F.2d at 1140, with added emphasis on the possibility of future violations. *KPMG Peat Marwick, LLP*, Exchange Act Release No. 34-43862 (Jan. 19, 2001), *aff'd sub nom KPMG v. SEC,* 289 F.3d 109 (D.C. Cir. 2002). The *Steadman* factors are: (1) the egregiousness of a respondent's actions, (2) the isolated or recurrent nature of his securities law infractions, (3) the degree of scienter involved, (4) the respondent's assurances against future violations, (5) the respondent's recognition of the wrongful nature of his conduct, and (6) the likelihood the respondent's occupation will present opportunities for future violations. *Steadman*, 603 F.2d at 1140. No one factor controls. *SEC v. Fehn*, 97 F.3d 1276, 1295-96 (9th Cir. 1996). The severity of the sanction appropriate in a particular case depends on the facts of the case and the value of the sanction in preventing recurrence. *Berko v. SEC*, 316 F.2d 137, 141 (2nd Cir. 1963); *In the Matter of Leo Glassman*, File No. 3-3758, 1975 WL 160534 at *2 (Dec. 16, 1975).

Here, all the factors weigh in favor of the Law Judge imposing cease-and-desist orders on both Respondents. Their actions were highly egregious. Their misrepresentations, omissions and

deceptive conduct ensured that Sovereign clients would be kept in the dark concerning the fees and compensation Grossman and Adams received from Battoo, and prevented clients from evaluating the conflict of interest in choosing to invest in the Battoo Funds and PIWM. Furthermore, Grossman and Adams turned a blind eye to the obvious red flags that indicated the Battoo Funds and PIWM were not safe, diversified and well-established investments. Grossman and Adams engaged in this conduct for the most selfish of reasons – their own financial interests. As a result of their conduct, hundreds of Sovereign clients lost the entirety of their investments. It is hard to imagine any more egregious conduct.

The actions of Grossman and Adams also were recurrent. They continued for years with the misrepresentations, omissions, and deceptive conduct. Each time a new client came to Sovereign, they were subjected to the same treatment. Grossman and Adams continued to profit at the expense of their clients. Moreover, Grossman and Adams continually failed to provide the correct disclosure of their compensation in the various Forms ADV filed with the Commission and in the IAAs they distributed to clients.

As discussed in several sections above, Grossman and Adams also displayed a high degree of scienter since they knew flat out that they were hiding the full truth about their compensation from clients and about the fact that the Battoo Funds and PIWM were not the investments that the PPM and other promotional materials portrayed them to be.

As to the fourth and fifth factors, Grossman and Adams have not acknowledged the wrongfulness of their conduct; consequently they have not given and cannot give any assurances against future misconduct. Finally, both Grossman and Adams remain employed in the industry and will have the opportunity to re-offend.

For all those reasons, the Law Judge should enter cease-and-desist orders against both

Respondents.

C. **Industry Bars Are Appropriate**

The same six *Steadman* factors apply to the consideration of a broker-dealer and related industry bars against Grossman and Adams. Here, applying the *Steadman* factors as we did in the immediately preceding section weighs heavily in favor of permanently barring Grossman and Adams from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; and prohibiting them from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

The Commission has held conduct like that of Grossman and Adams, which violates the antifraud provisions of the federal securities laws, "is especially serious and subject to the severest of sanctions under the securities laws." *In the Matter of Jose P. Zollino,* File No. 3-11536, 2007 WL 98919 at *5 (Jan. 16, 2007).

Here, the Division requests that the Law Judge collaterally bar Grossman and Adams from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; and prohibiting them from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter. Section 925 of the Dodd-Frank Wall Street Reform and Consumer Protection Act authorized the Commission to impose collateral bars in proceedings pursuant to Section 15(b) of the Exchange Act and Section 203 of the Advisers Act by amending Section 15(b)(6)(A) of the Exchange Act to "bar any such person

from being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization" and further amending Section 203(f) of the Advisers Act to "bar any such person from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization." P.L. 111-203 (July 21, 2010). The collateral bars Dodd-Frank authorized prohibit securities professionals found to have violated the securities laws from associating with any of the Commission-regulated entities specified in amended Exchange Act Section 15(b)(6)(A) and Advisers Act Section 203(f).

The Dodd-Frank Act's collateral bar provisions are applicable here even though the statute was not enacted until July 21, 2010, after the date of the conduct at issue. Although courts will not retroactively apply a statute under certain circumstances, "application of new statutes passed after the events in suit is unquestionably proper in many situations." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 273 (1994). For instance, in *Landgraf*, the Supreme Court stated "[w]hen the intervening statute authorizes or affects the propriety of prospective relief, application of the new provision is not retroactive" and is thus permitted. *Id.* One example of such prospective relief the *Landgraf* court specified is "relief by injunction" which necessarily "operates *in futuro*." *Id.* at 274. Because collateral bars, like the bars we seek against Grossman and Adams, are prospective relief designed to protect the public "*in futuro*," retroactivity concerns are not implicated by application of the Dodd-Frank collateral bar provisions.[13]

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[13] *But see*, *In the Matter of John W. Lawton*, 2011 WL 1621014 at *4 (Initial Decision April 29, 2011) (concluding in a follow-on proceeding pursuant to Section 203(f) of the Advisers Act, also amended by Dodd-Frank to provide collateral bar authority, that barring respondent from association with municipal advisors or nationally recognized statistical rating organizations constituted improper retroactive relief and declining to order such relief, but imposing a bar as to association with the other types of regulated entities enumerated in the amended Section 203(f) because such bars were statutory remedies available before Dodd-Frank).

Since long before Dodd-Frank was enacted, Section 15(b)(6)(A) of the Exchange Act and Section 203(f) of the Advisers Act have provided that the Commission may bar a person associated with a broker-dealer or an investment adviser who is found liable for certain misconduct from further association with a broker-dealer or investment adviser, if such a bar was "in the public interest" and certain specified criteria were satisfied. Section 925 of the Dodd-Frank Act amended those sections of the Exchange Act and the Advisers Act to permit the Commission to bar such an individual not only from association with a broker-dealer and investment adviser, but also from association with the other regulated entities enumerated in the amendment. The Commission's collateral bar authority under amended Sections 15(b)(6)(A) and 203(f) is a prospective remedy based on misconduct that was unlawful even prior to enactment of the Dodd-Frank Act. Consequently, a collateral bar against Grossman and Adams would limit their conduct only *in futuro*. In this respect, the collateral bar sought here is indistinguishable from the prospective injunctive relief the *Landgraf* court held does not raise retroactivity concerns.

Further, imposing a collateral bar is a remedial measure designed to protect the investing public from harm. Section 15(b)(6)(A) and Section 203(f) expressly provide a bar is appropriate only if "in the public interest," a phrase the Commission and the courts have interpreted to mean the remedy is not "punitive" but rather is "meant to protect the investing public." *Rizek v. SEC*, 215 F.3d 157, 163 (1st Cir. 2000). *See also Kornman v. SEC*, 592 F.3d 173, 188 (D.C. Cir. 2010) (holding a bar was "remedial in nature because it is designed to protect the public, and the sanction is not historically viewed as punishment" (internal quotation marks omitted)); *Brownson v. SEC*, 66 Fed. Appx. 687, 688 (9th Cir. 2003) (noting "the SEC's goal of protecting the public is remedial, not punitive"); *Vanasco v. SEC*, 395 F.2d 349, 353 (2nd Cir. 1968) (concluding a bar was "in the public interest" because it was based on the belief "the public should [not] be exposed

to further risk of fraudulent conduct"). Such prospective remedial relief designed to protect the public is appropriate even if based on misconduct committed prior to enactment of the statute in question. *Landgraf,* 511 U.S. at 274.

In light of these legal principles, a collateral bar is an appropriate remedy against Grossman and Adams. Further, their demonstrated egregious fraudulent conduct clearly warrants collaterally barring them from association with any regulated entity.

VI. CONCLUSION

For the foregoing reasons, the Law Judge should find Grossman and Adams violated Section 17(a) of the Securities Act; Section 15(a) of the Exchange Act; Sections 206(1), 206(2), 206(3), 206(4) and 207 of the Advisers Act and Advisers Act Rules 204-3 and 206(4)-2; and willfully aided and abetted violations of Section 206(4) of the Advisers Act and Advisers Act Rules 204-3 and 206(4)-2. We believe the evidence and the law support the sanctions we will ask the Law Judge to impose.

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Respectfully submitted,

Patrick R. Costello
Senior Trial Counsel
Direct Line: (305) 982-6380
Email: costellop@sec.gov

DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
801 Brickell Avenue, Suite 1800
Miami, FL 33131
Phone: (305) 982-6300
Fax: (305) 536-4154

EXHIBIT A

Misrepresentations and Omissions about Compensation During Grossman's Ownership of Sovereign

Relevant Sovereign Documents	Compensation Disclosure	Misleading Statements or Omissions
IAA (2006)	• N.1: The Advisor [Sovereign] may receive performance-based compensation from certain investment companies. • N. 2: Advisor [Sovereign] will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Advisor.	• The first disclosure is misleading because it omitted the fact that SIAM, LLC (which was under common control with Sovereign) actually was receiving (i) referral fees (sales load and management fees) from Anchor Hedge Fund and FuturesOne; and (ii) referral fees (management fees) from BC Capital related to PIWM. The disclosure also is misleading because it did not disclose that Sovereign received the initial 4.5% sales load Anchor Hedge Fund and PIWM charged to Sovereign's clients. Finally, the disclosure is misleading because Sovereign did not disclose that Grossman was in fact receiving advisory fees (based upon a percentage of management and performance related fees) from AHF Management. • The second disclosure is misleading because there is no evidence in this case that Sovereign ever notified its clients that it was in fact receiving compensation for referring them to Anchor Hedge Fund, FuturesOne, and BC Capital.
Form ADV Part II - brochure (2006, 2008)	• N.1: Sovereign may receive incentive or subscription fees from certain investment companies. • N.2: Sovereign may receive performance-based compensation from certain investment companies. • N.3: Sovereign will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Sovereign.	• The first disclosure is misleading because it omits the fact that SIAM, LLC was already receiving referral fees from Anchor Hedge Fund, FuturesOne, and BC Capital. • The second disclosure is misleading because Sovereign did not disclose that Grossman was in fact receiving advisory fees (based upon a percentage of management and performance related fees) from AHF Management. • The third disclosure is misleading because there is no evidence in this case that Sovereign ever notified its clients that it was in fact receiving compensation for referring them to Anchor Hedge Fund, FuturesOne, and BC Capital • Sovereign falsely stated in Item 13 of its brochure that Sovereign (or a related person) did not have an arrangement whereby it is paid cash or receives an economic benefit (including commissions, equipment, or non-research services) from a non-client in connection with giving advice to clients. • Sovereign falsely stated in Item 8 of its brochure that it did not have an arrangement with an investment company that was material to its advisory business or its clients.

		• Sovereign falsely stated in Item 9 of its brochure that Sovereign (or a related person) did not recommend to clients that they buy or sell securities or investment products in which the applicant or a related person has some financial interest. • The statements in Items 8, 9, and 13 of Sovereign's brochure are false because SIAM, LLC received referral fees from Anchor Hedge Fund, FuturesOne and BC Capital when Sovereign recommended investments in these funds and in PIWM to its clients. The disclosure also is false because it did not disclose that Sovereign received the initial 4.5% sales load Anchor Hedge Fund and PIWM charged to Sovereign's clients. • The statement in Item 9 of Sovereign's brochure also is false because Grossman (a related person) was in fact receiving advisory fees (based upon a percentage of management and performance related fees) from AHF Management.
Form ADV Part 1 (2004, 2005, 2006, 2007, and 2008)	None.	• Sovereign falsely states in Item 6 B. (1) that it was not actively engaged in any other business not listed in item 6A (other than giving investment advice) and falsely stated in Item 6 B. (3) and 7 that it did not sell products or provide services other than investment advice to its clients. • The statements in Items 6 B. (1), 6 B. (3) and 7 are false because Sovereign was actively referring its advisory clients to Anchor Hedge Fund, FuturesOne, and BC Capital (since at least November 2003). The statements also are false because Sovereign (acting as an unregistered broker-dealer) received transaction-based compensation for selling securities in Anchor Hedge Fund, FuturesOne, and BC Capital. • Sovereign falsely stated in Item 9 that it did not have a related person that had custody of its advisory clients' cash or securities even though by 2005 AH Florida had custody of Sovereign clients' investments funds or money.

EXHIBIT B

Misrepresentations and Omissions about Compensation During Adams' Ownership of Sovereign

Relevant Sovereign Documents	Compensation Disclosure	Misleading Statements or Omissions
IAA (2009)	• N.1: The Advisor [Sovereign] may receive performance-based compensation from certain investment companies. • N. 2: Advisor [Sovereign] will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Advisor.	• The first disclosure is misleading because it omitted the fact that SIAM, LLC (which was under common control with Sovereign) actually was receiving (i) referral fees (sales load and management fees) from Anchor Hedge Fund and FuturesOne; and (ii) referral fees (management fees) from BC Capital related to PIWM. The disclosure also is misleading because it did not disclose that Sovereign received the initial 4.5% sales load Anchor Hedge Fund and PIWM charged to Sovereign's clients. • The second disclosure is misleading because there is no evidence in this case that Sovereign ever notified its clients that it was in fact receiving compensation for referring them to Anchor Hedge Fund, FuturesOne, and BC Capital.
Form ADV Part II - brochure (2009 and 2010)	• N.1: Sovereign may receive incentive or subscription fees from certain investment companies. • N.2: Sovereign will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Sovereign.	• The first disclosure is misleading because it omits the fact that SIAM, LLC was already receiving referral fees from Anchor Hedge Fund, FuturesOne, and BC Capital. • The second disclosure is misleading because there is no evidence that Sovereign ever notified its clients that it was in fact receiving compensation for referring them to Anchor Hedge Fund, FuturesOne, and BC Capital • Sovereign falsely stated in Item 13 of its brochure that Sovereign (or a related person) did not have an arrangement whereby it is paid cash or receives an economic benefit (including commissions, equipment, or non-research services) from a non-client in connection with giving advice to clients. • Sovereign falsely stated in Item 8 of its brochure that it did not have an arrangement with an investment company that was material to its advisory business or its clients. • Sovereign falsely stated in Item 9 of its brochure that Sovereign (or a related person) did not recommend to clients that they buy or sell securities or investment products in which the applicant or a related person has some financial interest. • The statements in Items 8, 9, and 13 of Sovereign's brochure are false because SIAM, LLC received referral fees from Anchor Hedge Fund, FuturesOne and BC Capital when

		Sovereign recommended investments in these funds and PIWM to its clients. The disclosure also is false because it did not disclose that Sovereign received the initial 4.5% sales load Anchor Hedge Fund and PIWM charged to Sovereign's clients.
Form ADV Part 1 (2009 and 2010)	• In Item 5 (Information About Your Advisory Business-Compensation Arrangements): Sovereign receives referral fees for selection of other advisers.	• The disclosure is misleading because it did not disclose Sovereign's compensation arrangements with Anchor Hedge Fund, FuturesOne, and BC Capital Group. In fact, the statement is made in response to questions on the form about Sovereign's advisory business as opposed to more specific questions intended to elicit information about Sovereign's involvement in other business activities which could create potential conflicts of interest, such as Item 6.B.1. ("Other Business Activities"). Sovereign did not make any other changes to prior versions of its Form ADV Part 1.