UNITED STATES OF AMERICA
Before The
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15617

In the Matter of

LARRY C. GROSSMAN
and GREGORY J. ADAMS,

Respondents.

RESPONDENT'S, LARRY C. GROSSMAN'S PREHEARING BRIEF

Respondent, Larry C. Grossman, by and through his undersigned counsel and pursuant to the extension granted during the March 7, 2014, Prehearing Conference, files his prehearing brief and states as follows:

BACKGROUND

Sovereign International Asset Management, Inc. ("Sovereign") was a small investment advisory firm located in Palm Harbor, Florida, that was founded by Larry C. Grossman ("Grossman").[1] Sovereign offered boutique investment advisory services for individuals who wanted to have access to international diversification and alternative investments, such as hedge funds.

Generally, potential clients contact Sovereign after hearing Grossman speak at an international event where he provides his opinions on the U.S. and international markets and

[1] Sovereign and its related entities, Anchor Holdings LLC (FL limited liability company), Anchor Holdings, LLC (Nevis limited liability company, and SIAM, LLC (Anguilla limited liability company), were sold to Gregory J. Adams on October 1, 2008.

describes his investment strategy. After the presentation, a potential client would contact Sovereign resulting in a telephone conference with Grossman or one of Sovereign's representatives. If the potential client was interested in Sovereign's investment advisory services, then she would be sent new account documentation that included a series of documents seeking the potential client's financial information, investment experience, risk tolerance, investment objectives and a statement of whether they are a qualified or accredited investor. Included in the new account documentation was Sovereign's Investment Advisory Agreement and Form ADV Part II.

After receipt of the new account documents, Grossman or a Sovereign Representative prepared an investment proposal for the client explaining Sovereign's investment strategy, reasoning behind such strategy, and proposed investment vehicles to implement the strategy. ("Investment Proposal"). The Investment Proposal was provided to the client in advance of a scheduled telephone call during which Grossman or a Sovereign representative communicated specific investment recommendations. Sovereign then sent the client a letter, for the client's signature, memorializing the investment strategy by detailing the specific investments and their allocation. If Sovereign recommended investment into Anchor Hedge Funds Classes A or C (the "Anchor Funds"), FuturesOne Diversified Fund, Ltd. ("FuturesOne") or Private Wealth Management ("PIWM") ("collectively Investments")[2] then the appropriate Subscription Documents, including a Private Placement Memorandum, was also provided to the client.

[2] Grossman conducted significant due diligence in the Investments including: interviewing key personnel, and obtaining due diligence questionnaires, performance reports, audited financial statements and private placement memorandums. In fact, Grossman received audited financial statements and performance reports for the Investments up to the sale of Sovereign in October 1, 2008. Notably, as an investment advisor, Grossman is entitled to rely on the accuracy of these documents for purposes of recommending an investment and is not required to assume the role of accountant or private investigator to determine their accuracy. *Gabriel Capital, L.P. v. Natwest Finance, Inc.,* 137 F. Supp. 2d 251, 263(S.D.N.Y. 2000).

In 2004, the Securities and Exchange Commission's ("SEC" or "Commission") staff (the "Staff") engaged in a comprehensive audit of Sovereign (the "2004 Audit"). During the 2004 Audit, the Staff conducted a field examination at Sovereign's office in Palm Harbor, Florida ("Field Examination") where the Staff was provided unfettered access to documents and Sovereign's personnel, including Grossman. In fact, the Field Examination often included interviews with Grossman where Grossman would answer the Staff's questions regarding Sovereign's operations or documentation.

In response to the 2004 Audit, Sovereign provided the Staff with information and documentation relating to: (a) Grossman's due diligence into the Investments; (b) Referral Agreement between SIAM, LLC and FuturesOne for the payment of fees to SIAM, LLC; (c) Referral Agreement between Siam, LLC and BC Capital Group, S.A. for payment of fees to SIAM, LLC; (d) International Consulting Agreement between Anchor Hedge Fund Management Limited; (e) Sovereign's Investment Advisory Agreements; (f) Sovereign's ADVs; (g) Sovereign's disclosure of compensation; (h) financial statement, and (i) Sovereign's policies and procedures.

On February 7, 2005, after review of the Sovereign information and documentation, the Staff issued its "Request for Correction Action" identifying Sovereign's deficiencies and/or violations of law. Among such deficiencies noted in the Request for Corrective Action was the compensation disclosure in the ADV Part II. Sovereign followed the Staff's recommendations and provided the Staff with its response to the Request for Corrective Action.

On November 20, 2013, nine years after the 2004 Audit and over five years after Grossman sold Sovereign to Adams, the Commission filed its Order Instituting Proceedings ("OIP") against Grossman and Adams. The OIP alleges that Grossman violated several securities laws by: (1) failing to advise clients that Sovereign temporary pooled their funds into

Anchor Holdings, LLC to invest in off-shore funds; (2) failing to adequately disclose the fees received from the Referral Agreements and Consulting Agreements in the Investment Advisory Agreement or ADV; (3) misrepresenting the risks associated with the Investments; and (4) ignoring Anchor Hedge Fund Class C red flags while recommending that Sovereign client's continue to invest in such funds.

Grossman answered the OIP denying the alleged violations and asserted several defenses. The sole affirmative defense that remains for trial is Grossman's statute of limitations affirmative defense claiming that the Commission's remedies are barred by the five-year statute of limitations under 28 U.S.C. §2462.

DISCUSSION

I. THE COMMISSION IS BARRED FROM SEEKING ANY PENALTY, FINE OR FORFEITURE AGAINST GROSSMAN.

The OIP was filed on November 20, 2013. The statute of limitations with respect to civil fines, penalties or forfeiture, pecuniary or otherwise is five years from the date that the claim first accrued. *See Gabelli v. S.E.C.*, 133 S. Ct. 1216, 1217-18 (2013) *citing* 28 U.S.C. §2462 (abolishing tolling of statute of limitations based upon discovery rule and holding that a claim first accrues when the Commission has a complete and present cause of action, because it 'sets a fixed date when exposure to the specified Government enforcement efforts end, advancing the basic policies of all limitation provisions: repose, elimination of stale claims and certainty about a plaintiff's opportunity for recovery and a defendant's potential liability.'). As a result, any fines, penalties or forfeitures for claims that first accrued before November 20, 2008 are barred by §2462's five-year statute of limitations.

Although disgorgement is an equitable remedy, courts have recognized instances when equitable remedies rise to the level of a penalty and are subject to §2462's five-year statute of limitations. *See S.E.C. v. Microtune*, 783 F. Supp. 2d 867, 884 (N.D. TX 2011) aff'd *S.E.C. v. Bartek*, 484 Fed. Appx. 949 (5th Cir. 2012). For instance, the court in *Microtune* found that injunctive relief and a officer-and-director bar that the S.E.C. sought were a penalty subject to §2462's five year statute of limitation, because "neither remedy addresse[d] past harm caused by the defendants, and neither remedy is focused on preventing future harm due to the low likelihood that the defendant would engage in similar behavior in the future. *Id.* at 885-886. In arriving at its decision to classify the equitable relief as a penalty, the court examined the substantial collateral consequences that such remedies would have on the defendant's reputation and career.[3] *Id.* Although the court in *Microtune* did not specifically address whether disgorgement is subject to §2462's five-year statute of limitations, the Supreme Court in *Gabelli* left the door open regarding this issue. *See Gabelli v. S.E.C.* 133 S. Ct. 1216 at 1220 FN 1.

The analysis adopted by the Supreme Court in *Gabelli* for its refusal to allow §2462's five-year statute of limitations to be tolled by the discovery rule is equally applicable to equitable relief such as disgorgement, especially when such a remedy is tantamount to a penalty. For instance, one of the primary factors considered by *Gabelli* in refusing to toll the statue of limitations based on the discovery rule was the that the "central mission of the Commission is to investigate potential violations of the federal securities laws" and there should be a point in time where the potential violator should not have to worry about government action after memories fade and evidence is lost. *Id.* at 1222-1224.

[3] In determining whether a sanction is a penalty under § 2462, this court must objectively consider the degree and extent of the consequences to the subject of the sanction ... as a relevant factor." *Id.* at 488.

During the 2004 Audit, the Staff carried out its duty by investing Sovereign for potential violation of securities laws. Sovereign and Grossman complied with the 2004 Audit, including providing the Staff with the Referral and Consulting Agreements, ADVs and Investment Advisory Agreements that are also the centerpiece of the current OIP. During the ensuing years, Sovereign operated under the impression that it was in compliance with the appropriate rules and regulations. The Commission, however, waited over nine (9) years to take action against Sovereign and Grossman, and all of the claims asserted against Grossman first accrued five years before the filing of the OIP. For the very same reasons espoused by the courts in *Gabelli*, *Microtune* and *Bartek,* the Commission's claims for disgorgement against Grossman should also be barred by §2462's five-year statute of limitations. At a minimum, the Commission's claims for injunctive relief and an associational bar against Grossman are penalties barred by §2462's five-year statute of limitations.

II. SOVEREIGN'S COMPENSATION DISCLOSURE IS NOT MISLEADING

The Commission does not allege that Grossman completely failed to disclose referral and consulting fees received by Anchor Hedge Fund Management, Ltd. or B.C. Capital. Instead, the Commission alleges that the disclosure of such fees in Sovereign's Investment Advisory Agreement and ADV were misleading. The fees, however, were disclosed in Section 10 and Schedule A of Sovereign's Investment Advisory Agreement[4], 2006 ADV Schedule F[5], Private Placement Memoranda[6] and Subscription Agreements.[7] As a result, the referral fees ultimately

[4] "[T]he Advisor may receive performance-based compensation from certain investment companies.

[5] "SIAM may receive incentive or subscription fees from certain Investment companies. SIAM may receive performance-based compensation from certain Investment companies."

[6] Private Placement Memoranda for the Anchor Hedge Funds disclosed that the funds investment manager, Anchor Hedge Fund, Ltd., may appoint investment advisers to whom its pays fees and expenses to be borne by the investment manager.

payable to Sovereign and Grossman were properly disclosed and the Sovereign clients that were placed into the Investments were not misled.

III. NO CAUSAL CONNECTION BETWEEN GROSSMAN'S ALLEGED VIOLATION AND THE AMOUNT TO BE DISGORGED.

The Commission seeks to disgorge all fees that Grossman and Sovereign received under the referral and consulting agreements from 2003 through October 1, 2008 arising from Grossman's alleged misrepresentations regarding Anchor Hedge Fund Classes A and C, failure to detect "red flags" with respect to Anchor Class C, and the alleged misleading fee disclosures. It is the Commission's burden to distinguish between gains that were legally and illegally obtained. *See SEC v. Seghers*, 404 Fed. Appx. 863, 864 (5th Cir. 2010). The Commission cannot sustain its burden to show a causal connection between the amount to be disgorged, namely all of the fees received from 2003 through October 1, 2008, and the alleged violations absent presenting testimony from each of the Sovereign clients who were misled by the misleading omissions or statements. *See SEC v. Blatt,* 583 F.2d 1325, 1335 (5th Cir.1978); *SEC v. Manor Nursing Centers, Inc.,* 458 F.2d 1082, 1104 (2d Cir.1972)(the court can exercise its equitable power only over property causally related to the wrongdoing) S*ee also In re Joseph J. Barbato*, 1999 WL 58933 (S.E.C. Release Feb. 10, 1999)(rejecting the Commission's claims for disgorgement of all fees received by broker-dealer received from all clients over the course of several years holding that the commission could only seek disgorgement with respect to the customers who testified at trial).

---

[7] The Subscription Agreements, attached to the Private Placement Memoranda, disclosed the initial subscription fee for each investment.

IV. SOVEREIGN DID NOT ACT AS AN UNREGISTERED BROKER-DEALER.

The principal factors considered in determining whether an entity is a broker-dealer under Section 15(a) of the Exchange Act are: (1) active solicitation of investors, (2) advising investors as to the merits of any investment, (3) regular participation in securities transactions, and (4) receipt of commission or transaction-based remuneration. During Grossman's ownership of Sovereign, Sovereign was a registered investment adviser that did not actively solicit clients to purchase specific investments. To the contrary, Grossman spoke at international events concerning his views on the world economy and his investment strategy. It was after such presentations that investors contacted Sovereign regarding retaining Sovereign as their investment adviser. Upon such contact, Sovereign obtained the new account documentation, conducted discussions with the clients, and ultimately recommended a specific investment.

CONCLUSION

At the conclusion of the final hearing, Grossman will request that the Court: (1) find that Grossman did not violate the securities laws as alleged in the OIP; (2) bar any fine, penalty or forfeiture arising from any claims that first accrued before November 20, 2008 as being beyond §2462's five year statute of limitations; and (3) find that the equitable remedy of disgorgement is tantamount to a penalty and bar any claims that first accrued before November 20, 2008 as being beyond §2462's five-year statute of limitations or in the alternative, find the disgorgement sought by the Commission is not causally related to the alleged violations.