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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.

DIVISION OF ENFORCEMENT'S INITIAL POSTHEARING BRIEF AND PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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

Sunny H. Kim
Senior Counsel
Direct Line: (305) 416-6250
Email: kimsu@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 a principal of Sovereign International Asset Management, Inc. ("Sovereign"), an investment adviser registered with the Commission until February 6, 2013.

Respondent Larry C. Grossman 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 another Commission case. Grossman misrepresented his compensation and failed to disclose to Sovereign clients that in exchange for recommending they invest in Battoo's hedge funds and managed accounts, Battoo paid Grossman more than $3.4 million.

In addition, at investment conferences and in written materials, Grossman represented to clients that he chose Battoo's funds based on an extensive selection and due diligence process. He further promoted Battoo's funds as safe, diversified, independently administered, audited, and suitable for the investment objectives and risk profiles of Sovereign clients, most of whom were retirees. In fact, investments in Battoo's funds were risky, lacked diversification, and lacked independent administrators and auditors. Grossman 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] As set forth more fully below, the Division of Enforcement has shown Grossman willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act"); Section 15(a) of the Securities

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[1] Prior to the start of the hearing, the Commission accepted the offer of settlement of the co-respondent, Gregory J. Adams, under which Adams agreed to a cease-and-desist order, collateral associational bars, disgorgement and a third-tier civil penalty. The Commission ordered the continuation of the proceedings to determine the amount of disgorgement, prejudgment interest and a civil penalty that Adams shall pay. The Law Judge previously indicated she would consider the issues in a motion for summary disposition from the Division with supporting materials as applicable. The Division will present its arguments against Adams in that motion once the Law Judge has set a briefing schedule. The instant posthearing brief and proposed findings of fact and conclusions of law, therefore, are limited just to Grossman.

Exchange Act of 1934 ("Exchange Act"); and Sections 206(1), 206(2), 206(3) and 207 of the Investment Advisers Act of 1940 ("Advisers Act"); and willfully aided and abetted and caused violations of Section 15(a) of the Exchange Act, Section 206(4) of the Advisers Act, and Advisers Act Rules 204-3 and 206(4)-2.

II. PROPOSED FINDINGS OF FACT

A. Respondent

1. **Grossman**, 58, resides in Tarpon Springs, Florida, and was Sovereign's founder, managing partner, and sole owner 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. (Tr. Vol. I at 174:19-23; DX 1 at 1; Answer ¶ 1.)[2] Grossman currently is the principal manager of Sovereign International Pension Services, Inc., an IRA administrator ("SIPS"). (Answer ¶ 1.)

B. Related Parties

2. **Sovereign** was a Florida corporation with its principal place of business in Clearwater, Florida, that Grossman incorporated in 2001. (Tr. Vol. I at 168:18-24; Answer ¶¶ 3, 10.) Sovereign was an investment adviser registered with the Commission. (Tr. Vol. I at 170:11-13.) In October 2008, Grossman sold Sovereign to Adams. (Answer ¶ 3.) From the time of Sovereign's incorporation until the time he sold it to Adams, Grossman was the owner of Sovereign. (Tr. Vol. I at 176:1-5.)

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[2] The hearing in this matter took place on March 24-26 and April 8, 2014. The transcripts for each day of the hearing are paginated consecutively in four volumes. Therefore, we cite references to the transcripts as "Tr. Vol. __ at __:__." We cite references to the Division's exhibits as "DX at __" and references to Respondent Grossman's exhibits as "GX at __." References to the "Answer" refer to Respondent Grossman's Answer and Affirmative Defenses dated December 12, 2013.

3. **SIAM LLC** is a limited liability company Grossman formed in April 1999 and registered in Anguilla. (Tr. Vol. I at 170:14-21; Answer ¶ 4.) Grossman sold SIAM LLC to Adams in conjunction with the sale of Sovereign in October 2008. (Answer ¶ 4.) From the time of SIAM LLC's formation until the time he sold it to Adams, Grossman was the owner of SIAM LLC. (Tr. Vol. I at 176:6-10.)

4. **AH Florida** is a limited liability company Grossman registered in Florida in 2005, using the same "Anchor Holdings" name as AH Nevis. (Tr. Vol. I at 173:6-10; Answer ¶¶ 5, 13.) Grossman sold AH Florida to Adams in October 2008. (Answer ¶ 5.) From the time of AH Florida's formation until the time he sold it to Adams, Grossman was the owner of AH Florida. (Tr. Vol. I at 176:11-15.)

5. **AH Nevis** is a company Grossman formed and registered in Nevis in September 2004. (Tr. Vol. I at 173:17-22; Answer ¶ 6.) Grossman sold AH Nevis to Adams in conjunction with the sale of Sovereign in October 2008. (Answer ¶ 6.) From the time of AH Nevis's formation until the time he sold it to Adams, Grossman was the owner of AH Nevis. (Tr. Vol. I at 176:16-20.)

6. **Battoo** was the principal of BC Capital Group, S.A. (Panama) and BC Capital Group Limited (Hong Kong), collectively referred to herein as "BC Capital." (DX 18 at 4.) Through BC Capital, Battoo operated offshore hedge funds. (*Id.*) He also offered managed account services through Private International Wealth Management ("PIWM"). (*Id.*; DX 21 at 5.) The Commission named Battoo as a fraud defendant in the United States District Court for the Northern District of Illinois in *SEC v. Nikolai S. Battoo, et al.*, N.D. Ill. Case No 12-CV-7125. (Answer ¶ 7.) The District Court action 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. (DX 18.)

7. **Anchor Hedge Fund Limited** ("Anchor Hedge Fund") was incorporated in the British Virgin Islands in September 2002. (Answer ¶ 8.) Grossman was a consultant to Anchor Hedge Fund and, along with Battoo, a member of its investment advisory board until at least July 2008. (*Id.*; *see also* DX 2 at 6; DX 152 at 51:2-12; DX 50 at ¶ 11.)[3] Battoo owned BC Capital Group Limited (Hong Kong), and thus controlled a majority ownership interest in Anchor Hedge Fund. (DX 19 at 9-10.)

8. **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. (DX 19 at 9-10; Answer ¶ 9; *see also*, *e.g.*, DX 25 at 5; DX 28 at 5.) BC Capital Group Limited (Hong Kong) had a majority ownership interest in AHF Management. (DX 19 at 9-10.)

C. Sovereign's Operations

(a) Company Overview

9. Before Grossman sold Sovereign to Adams in October 2008, Sovereign was an investment adviser registered with the Commission. (Answer ¶ 10; Tr. Vol. I at 170:11-13.) At its peak in 2008, Sovereign reported $85 million in assets under management. (DX 34 at 8; DX 40 at 8; DX 84 at 8.) Sovereign was a small organization run by Grossman, Sovereign's sole control person, until he sold it to Adams in October 2008. (Answer ¶ 10.) Sovereign employed a small staff, mostly of support personnel, of less than ten people. (*Id.*; Tr. Vol. III at 639:21-25; 640:1-4.) No one at Sovereign was a registered representative associated with a broker-dealer during Grossman's ownership of Sovereign. (DX 34 at 6; DX 35 at 7; DX 37 at 7; DX 38 at 7; DX 39 at 7; DX 40 at 6; DX 83 at 6; DX 84 at 6.)

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[3] The Division also notes that in his Answer, Grossman does not deny the allegation in Paragraph 8 of the OIP that he was a member of Anchor Hedge Fund's investment advisory board. *See* Answer ¶ 8. Under Rule 220(c) of the Commission's Rule of Practice, therefore, because Grossman does not deny this allegation, it is deemed admitted for purposes of this proceeding.

10. Sovereign and Grossman targeted retirees seeking to invest their money offshore, and most of Sovereign's clients were retirees with self-directed IRAs. (Tr. Vol. I at 28:12-13; 189:11-15.) 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." (DX 46B at 3.) Moreover, he told clients he performed due diligence on the funds he recommended. (Tr. Vol. I at 51:9-13.) Grossman, however, never disclosed the due diligence process. (DX 152 at 17:9-11.)

11. During Grossman's ownership of Sovereign, the company maintained a website that prospective and current clients could access to learn more about Sovereign's services, and Sovereign, through Grossman, also actively solicited prospective clients. (Tr. Vol. I at 197:1-15; DX 50 at ¶ 3.)

12. Sovereign clients relied on Grossman's credentials as an expert in offshore investments and as a Certified Investment Management Analyst (CIMA) designee.[4] (Tr. Vol. I at 26:15-18; DX 152 at 14:17-19.) Indeed, Grossman was a frequent presenter on offshore investments at conferences around the world, authored a book and more than one hundred articles on the subject, and even served as a Fox Business News contributor. (Tr. Vol. I at 190:1-4, 191:8-12; Tr. Vol. III at 643:4-5, 7-8; DX 44.) At the time of the events in question in this case, Grossman had been specializing in the area of offshore investments for over 20 years. (Tr. Vol. I at 195:2-4.) Most Sovereign clients were novices when it came to alternative investments, such as hedge funds, and their reliance on Grossman's experience in the area was a determining factor in their choosing to do business with him. (*See id.*; *see also* Tr. Vol. I at 27:18; 107:10-11; DX 152 at 21:7-9.) In addition, Sovereign clients specifically told Grossman their investment goals were to preserve their base

[4] The CIMA designation is awarded by the Investment Management Consulting Association in conjunction with the Wharton School of Business at the University of Pennsylvania. (Tr. Vol. III at 632:3-6.) Investment advisers with CIMA designations receive training in highly quantitative market evaluation, investments, risks and statistics. (*Id.* at 632:6-9.)

retirement funds, achieve capital growth, and invest in low to medium risk portfolios. (Tr. Vol. I at 33:2-3; DX 152 at 22:10-16; DX 50 at ¶¶ 4, 6.)

13. Despite his clients' investment goals, and despite his representations concerning due diligence on the funds he recommended, Grossman advised Sovereign clients to invest almost exclusively in hedge funds and a managed account Battoo controlled (collectively, the "Battoo Funds"), regardless of the clients' investment objectives. (Tr. Vol. II at 354:4-11; 453:19-23; DX 50 at ¶ 16; DX 152 at 38:14-19.) Indeed, Grossman never mentioned investments other than the Battoo Funds to clients, and only identified the Battoo Funds when he presented his final written investment recommendations, despite having discussed alternative investments such as hedge funds generally with clients before finalizing his written proposals. (DX 50 at ¶ 16; DX 152 at 30:13-20.)

14. The Battoo Funds consisted of: 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); and in PIWM, a managed account for which Battoo served as manager. (Tr. Vol. I at 202:10-13, 216:13-16, 204:19-21; DX 19 at 6, 17; DX 66 at 5; DX 67 at 5.)

(b) Sovereign and Grossman Pooled Client Funds at AH Florida

15. 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. (Tr. Vol. I at 173:6-10; Answer ¶¶ 5, 13.) Sovereign, through Grossman, instructed its clients who wished to invest in the Battoo Funds or PIWM to transfer their money to AH Florida's bank account at EverBank. (*Id.* at 225:23-25-226:1-2.) Sovereign gave its clients a document called "Anchor Hedge Fund Application for Shares," which identified AH Florida as an intermediary, and included a wire transfer form authorizing a transfer to AH Florida's account at EverBank. (Answer ¶ 13; Tr. Vol. I at 226:3-5.)

16. Sovereign pooled all of the funds its clients invested in the Battoo Funds and PIWM in AH Florida's bank account at EverBank, for which Grossman was a signatory and had the authority to obtain possession of the funds. (Tr. Vol. I at 229:13-19; 228:6-10, 14-18.) Grossman did not tell Sovereign clients, either orally or in writing, that Sovereign would pool their investment funds in AH Florida's bank account. (Tr. Vol. I at 69:20-23, 124:19-23; DX 152 at 74:2-11.) Each client completed an application for the shares in question, which led them to believe they had individual investments. (Tr. Vol. I at 222:10-15; Tr. Vol. I at 69:24-25, 70:1-13, 125:3-5, 126:7-8; DX 50 at ¶ 22.) Although Grossman gave Battoo the names of the Sovereign clients investing in the Battoo Funds and PIWM, Grossman did not make the investments in the name of the individual clients; instead, he made them in the name of AH Nevis. (Tr. Vol. I at 230:12-19.)

17. After pooling client funds in AH Florida's bank account at EverBank, Grossman transferred the funds offshore to the accounts used by the administrators of the Battoo Funds and PIWM. (Tr. Vol. I at 230:4-11.) Because of the similarity in names, Sovereign clients believed the AH Florida account actually was an account belonging to Anchor Hedge Fund. (Tr. Vol. I at 42:20-21, 67:2-8, 69:69:4-9, 121:15-22; DX 50 at ¶ 23.) Grossman never disclosed his ownership of AH Florida to clients. (*See id.*)

18. 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. (Tr. Vol. I at 231:2-8.) Although Sovereign sent statements to clients regarding their purported investments in the Battoo Funds, there were no surprise annual exams of Sovereign during the time Grossman owned the company.[5] (Tr. Vol. I at 201:20-23.)

19. During Grossman's ownership of Sovereign, the company failed to disclose in Item 9 of its Form ADV Part 1 that it or a related entity (AH Florida) had custody of client assets.

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5 There also were no surprise annual exams during Adams' ownership. (Tr. Vol. II 492:18-21.)

(DX 83 at 12; DX 35 at 13; DX 78 at 13; DX 37 at 13; DX 38 at 13; DX 39 at 13; DX 40 at 13; DX 34 at 12-13.) Prior to filing, Grossman reviewed and signed the Form ADVs Part 1 on behalf of Sovereign, subject to the penalties of perjury. (Tr. Vol. II at 394:2-10, 15-20; 395:1-16; 397:12-17, 20-25; 398:1-11; 400:2-25; 401:1-5; 402:25; 403:1-25; 405:7-25; 406:1-4, 18-25; 407:1-16; 408:15-25; 409:1-15; 420:13-25; 421:1-11.)

20. In addition, during Grossman's ownership of Sovereign, the company's policies and procedures manual provided that Sovereign "does not permit employees or the firm to accept or maintain custody of client assets. It is our policy that all funds, securities, and other assets of each of our clients will be maintained in the name of the respective client and held for safekeeping by the bank, broker-dealer, or other custodian handling each client's respective account." (DX 10 at 21.) Grossman himself was responsible for enforcing the policies and procedures manual, including the company's rule on custody. (Tr. Vol. I at 234:4-8, 22-25; 235:1.)

(c) Grossman Sells Sovereign to Adams

21. On October 1, 2008, Grossman sold Sovereign to Adams. (Answer ¶ 16.) 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." (DX 64 at 1; DX 151 at 3-4; Tr. Vol. I at 76:7-12, 77:14-18, 134:14-19, 135:9-13, 165:8-9.) Although the letter did not specifically refer to the Battoo Funds by name, at the time of the sale of Sovereign to Adams, 75% of Sovereign clients were invested almost entirely in the Battoo Funds. (Tr. Vol. II at 453:19-23.) Indeed, at the time of the sale, Sovereign clients were not invested in any hedge funds other than the Battoo Funds and PIWM. (*Id.* at 482:21-25; 483:1.)

22. The letter introduced Adams and informed clients that Adams had been named Sovereign's President and Chief Investment Officer. (DX 64 at 2.) 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." (*Id.*) The letter did not actually mention, however, that Grossman had sold Sovereign to Adams, and Sovereign clients were still under the assumption, even following the sale, that Grossman remained their investment adviser. (Tr. Vol. I at 54:23-25, 55:1-2, 76:7-12, 77:14-18, 134:14-19, 135:9-13, 16-22. 165:8-9; DX 50 at ¶ 28.) Indeed, Grossman's own witness, C.W. Gilluly, testified at the hearing he did not learn of the sale until the first quarter of 2009. (Tr. Vol. II at 560:13-20.)

23. Following the sale of Sovereign to Adams, Grossman continued to be listed as an associated person in Sovereign's Form ADV Part II, dated October 30, 2008. (DX 42 Sch. F at 4.) In addition:

- Sovereign clients testified at the hearing that Grossman worked with them on their investments in mid-October 2008 and January 2009 and continued to serve as, and represented that he remained, their investment advisor[6] (Tr. Vol. I at 54:10-13, 23-25; 55:1-2; 81:15-19; 137:5-16; 160:18-21; DX 152 at 95:11-18);

- Sovereign clients testified Grossman reached out to them in mid-October 2008 to supplement client files (DX 152 at 77:1-9; DX 152 at Ex. 12);

- Sovereign clients testified Grossman made specific investment recommendations to them on November 21, 2008 (Tr. Vol. I at 145:14-20, 25; 146:1-6; DX 113 at 2; DX 113-1 at 2);

- Sovereign clients testified Grossman worked with them on the status of their Anchor Hedge Fund investments after November 18, 2008 and into 2009 (DX 152 at 104:15-21; DX 152 at Ex. 15);

- Adams testified Grossman remained on the Sovereign payroll as a paid consultant, assisting Adams with the transition of Sovereign's business and client relations; Grossman received a paycheck as late as March 23, 2009 (Tr. Vol. II at 454:6-17; DX 48 at 3);

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[6] Adams acknowledged at the hearing he was not present during every phone call or conversation Grossman had with clients, so Adams was unaware of whether Grossman was telling clients, after the sale of Sovereign or even later in 2009, to retain their investments in the Battoo Funds and PIWM. (Tr. Vol. II at 497:23-25; 498:1-4.)

- Adams testified that in 2009, when Battoo completed an audit of investments in PIWM, Battoo shared and discussed the audit with Grossman, but not with Adams, even though at the time of the audit, Grossman already had sold Sovereign to Adams (Tr. Vol. II at 472:16-19);[7]

- Grossman promoted Sovereign's status as an SEC-registered investment advisor and told a prospective investor on February 11, 2009 that Sovereign had the capability to take the investor's plan offshore (DX 120 at 2);

- Grossman continued to assist Adams as an investment advisor as late as February 19, 2010 (DX 123 at 1); and

- Grossman and Adams planned, as late as December of 2010, to meet on a weekly basis to discuss Sovereign's operations (DX 119 at 1).

24. These activities led Sovereign clients to believe Grossman remained their investment adviser. (Tr. Vol. I at 54:23-25, 55:1-2, 81:15-19, 135:16-22.) Moreover, SIPS, the company Grossman controls, continued to act as an IRA administrator for Sovereign's clients. (Tr. Vol. I at 177:5-9, 24-25, 178:1-4.) Additionally, Sovereign and SIPS after November 21, 2008 and into 2009: (i) continued to share the same computer system, with joint control of each company's files and client information, and the ability to access data entries and even change them; (ii) interchanged employees, with SIPS employees performing Sovereign functions and Sovereign employees performing SIPS functions; and (iii) shared office space. (Tr. Vol. II at 569:21-25; 587:8-14; 595:2-5, 15-23.) In fact, during that time period, a prospective client entering the Sovereign/SIPS office would have no way of telling what operations were Sovereign's and what where SIPS' unless they asked. (*Id.* at 596:11-17.)

25. The investment recommendations Grossman made to Sovereign clients on November 21, 2008 concerned the swap of shares between Anchor Hedge Fund Class C and PIWM. Sovereign clients testified they received the recommendation in a letter Grossman signed. (Tr. Vol. I at 145:25, 146:1-6; *see also* DX 113-1.) Grossman's witness, Jessina Paturzo, claimed on direct

[7] Adams testified at the hearing he never asked Battoo why Battoo shared the audit with Grossman but not with Adams. (*Id.* at 476:18-21.)

examination at the hearing that: (i) Grossman did not sign the letters; (ii) she was instructed to send the letters to the clients; (iii) she was a new employee of Sovereign at the time; (iv) Sovereign was understaffed; and (v) she had made a mistake in choosing the wrong form letter to send. (Tr. Vol. II at 574:20-25; 575:20-25; 576:1-6.) However, on cross examination, Paturzo admitted she was not a new employee, but had been working for Sovereign for eight months prior to sending out the letters; that she was, in fact, very familiar with the correct client forms Sovereign used; that she used Sovereign letterhead for the letters instead of SIPS letterhead; that Grossman himself continued to have access to the computer system where the letters resided; and that Grossman, along with other employees, had the ability to retrieve files and change them subsequently. (*Id.* at 582:6-12; 587:1-3, 8-14; 594:17-22; 602:1-4.) In addition, Adams, who was in charge of Sovereign at the time clients received the written recommendations from Grossman (DX 113, DX 113-1), recognized the forms used for the recommendations, and testified he could not state for sure that Grossman did not send the recommendations to Sovereign clients. (Tr. Vol. II at 502:23-25; 503:1-4; 507:18-20.)

D. Misrepresentations and Omissions to Investors

(a) Grossman Failed to Disclose More Than $3.4 Million in Compensation from Battoo for Referring Clients and Providing Advisory Services to the Battoo Funds and PIWM.

26. Grossman met Battoo at the end of 2002 at a conference in Panama. (Tr. Vol. I at 235:2-8.) A few months later, on January 17, 2003, Sovereign sent an email to clients stating it had taken on an active role as an investment adviser to Battoo's Anchor Hedge Fund. (DX 23 at 3-4; Tr. Vol. I at 239:13-16.) Sovereign represented to clients it received no additional compensation, but was "privy to and part of many investment decisions that are made." (DX 23 at 4.)

27. Contrary to this representation, however, Sovereign was much more than an investment adviser to Anchor Hedge Fund. Instead, Sovereign was a referral source for Battoo, the Battoo Funds, and PIWM. (Tr. Vol. II at 354:4-11; 453:19-23.) Indeed, Battoo himself considered

Grossman to be "part of us." (DX 30 at 1.) Grossman, from August 2003 until at least March 2009, when he stopped acting as a paid consultant, advised the majority of Sovereign's clients to invest and remain invested almost exclusively in the Battoo Funds and PIWM. (Tr. Vol. II at 354:4-11; 532:14-19.) 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. (Tr. Vol. II at 453:19-23.) And because the Battoo Funds were funds of funds, Sovereign clients paid multiple layers of fees. (Answer ¶ 21.)

(i) The Referral and Consulting Agreements with Battoo

28. 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:

- 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.

(Answer ¶ 22; DX 19 at 9; *see also* DX 71, 72, 73, 74.) The Anchor Referral Agreement, FuturesOne Referral Agreement and PIWM Referral Agreement triggered referral fees to Sovereign, paid to SIAM LLC, for referring Sovereign clients to the Anchor Hedge Fund, FuturesOne and PIWM. (Answer ¶ 23; DX 71, 72, 73.) The Consulting Agreement triggered consulting fees paid to Grossman. (DX 74.) In addition, 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. (DX 74 at 3.)

29. Under the Anchor Referral Agreement, Anchor Hedge Fund paid SIAM LLC a 1% sales load when a Sovereign client invested in Anchor Hedge Fund Classes A and B, and a 2% sales load when a Sovereign client invested in Anchor Hedge Fund Classes E and I. (DX 71 at 6; Tr. Vol. II at 356:12-17; 358:2-5.)[8] Sovereign clients invested in Anchor Hedge Fund during Grossman's ownership of Sovereign. (Tr. Vol. II at 366:1-5.) Sovereign clients paid the sales load upon investing in the fund, and Anchor Hedge Fund deducted the sales load from the principal amount of the clients' investments and subsequently paid it to SIAM LLC. (*Id.* at 357:24-25.) Anchor Hedge Fund made the payment to SIAM LLC's bank account at Jyske Bank in Denmark (the "Jyske Bank Account"). (*Id.* at 358:7-11.)

30. Under the FuturesOne Referral Agreement, FuturesOne paid SIAM LLC a 2% sales load and 50% of the fees earned by the investment manager of the fund when a Sovereign client invested in FuturesOne Classes A and B.[9] (DX 72 at 6; Tr. Vol. II at 360:2-7; 363:17-22.) Sovereign clients invested in FuturesOne during Grossman's ownership of Sovereign. (Tr. Vol. II at 363:3-6.) Sovereign clients paid the sales load and investment manager fees upon investing in the fund, and FuturesOne deducted the sales load and the fees from the principal amount of the clients' investments and subsequently paid them to SIAM LLC. (*Id.* at 360:22-25; 361:1-3, 17-24.) FuturesOne made the payment to the Jyske Bank Account. (*Id.* at 362:23-25; 363:1-2.)

31. Under the PIWM Referral Agreement, BC Capital paid SIAM LLC half of the 1%-2% annual management fee Battoo earned when a Sovereign client invested in PIWM. (DX 73 at

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[8] A "sales load" is a fee an investor pays upon investing in a hedge fund. (Tr. Vol. II at 356:18-21.) In other words, it is a cost-of-entry fee.

[9] Innovative Financial Holdings Limited ("Innovative") was the investment manager of FuturesOne. (DX 66 at 5; DX 67 at 5.) BC Capital controlled 100% of Innovative. (DX 19 at 17.) As noted above, Battoo controlled BC Capital, and thus also controlled Innovative.

6; Tr. Vol. II at 364:20-23.) Sovereign clients invested in PIWM during Grossman's ownership of Sovereign. (Tr. Vol. II at 365:23-25.) Sovereign clients paid the management fees upon investing in PIWM, and BC Capital deducted the fees from the principal amount of the clients' investments and subsequently paid them to SIAM LLC. (*Id.* at 365:18-22.) BC Capital made the payment to the Jyske Bank Account. (*Id.* at 366:6-10.)

32. Under the Consulting Agreement, AHF Management paid Grossman half of the 1% management fee Battoo earned when a Sovereign client invested in the Anchor Hedge Fund. (DX 74 at 4; Tr. Vol. II at 368:14-18; 370:20-24.) Grossman also earned an additional performance fee related to the new net profits of a Sovereign client's investment in the Anchor Hedge Fund. (DX 74 at 4; Tr. Vol. II at 369:19-25; 370:20-24.) Sovereign clients invested in the Anchor Hedge Fund during Grossman's ownership of Sovereign. (Tr. Vol. II at 371:1-5.) Sovereign clients paid the management fees upon investing in the Anchor Hedge Fund, and AHF Management deducted the fees from the principal amount of the clients' investments and subsequently paid them to SIAM LLC. (*Id.* at 370:20-24.) AHF Management made the payment to the Jyske Bank Account. (*Id.* at 371:6-10.)

33. In addition to those four agreements, there also was an oral agreement between Anchor Hedge Fund and SIAM LLC (the "Oral Agreement"), under which SIAM LLC would receive an additional 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. (Tr. Vol. II at 371:18-23; 372:4-17; *see also*, *e.g.*, DX 25 at 18; DX 28 at 18; GX 62 at 8.) The 4.5% was paid to the Jyske Bank Account. (Tr. Vol. II at 373:21-25; 374:1.) (The Anchor Referral Agreement, FuturesOne Referral Agreement, PIWM Referral Agreement, Consulting Agreement and Oral Agreement are hereinafter referred to collectively as the "Referral and Consulting Agreements").

34. During Grossman's ownership of Sovereign, the Jyske Bank Account was not used for any purpose other than receiving the fees and compensation under the Referral and

Consulting Agreements. (Tr. Vol. II at 376:21-25; 377:1-2.) In addition, during Grossman's ownership of Sovereign, SIAM LLC did not receive any fees and compensation under the Referral and Consulting Agreements that were not paid to the Jyske Bank Account. (*Id.* at 377:6-11.)

35. During Grossman's ownership of Sovereign, the Jyske Bank Account consisted of two subaccounts – one denominated in Euros and the other in U.S. Dollars. (*Id.* at 379:23-25; 380:1-25; *see also generally* DX 75.) During Grossman's ownership of Sovereign, the total fees and compensation paid to the Euro subaccount of the Jyske Bank Account under the Referral and Consulting Agreements was $529,172.66.[10] (DX 154; DX 75.) In addition, during Grossman's ownership of Sovereign, the total fees and compensation paid to the U.S. Dollar subaccount of the Jyske Bank Account under the Referral and Consulting Agreements was $2,878,593.00. (DX 153; DX 75.) Accordingly, the total fees and compensation paid to the Jyske Bank Account under the Referral and Consulting Agreements during Grossman's ownership of Sovereign was $3,407,765.66.[11] (Tr. Vol. II at 612-13, 617:5-8; DX 153; DX 154; DX 75.)

(ii) Misrepresentations and Omissions Concerning the Referral and Consulting Agreements in Sovereign's Form ADV Parts 1 and II

36. 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, which provides that an investment adviser must deliver the Form ADV Part II to a client at the time the adviser enters into an advisory contract with the client, and also annually if there have been material changes since the last ADV was provided. (Tr. Vol. I at 43:12-16; DX 152 at 83:18-23.) In addition, there was no evidence introduced at the hearing that Sovereign clients consented to delivery of the Form ADV Part II through a website. *See* Advisers Act Rule 204-3(b)(2)(ii).

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[10] The Division's forensic accountant, Kathleen Strandell, converted the Euro figures into U.S. Dollars. (Tr. Vol. II at 613:18-25; 614:1-2.)

[11] Grossman elected not to cross-examine Strandell at the hearing in this case and did not challenge her testimony or the calculations she performed.

37. With respect to Sovereign's Form ADV Part 1, during Grossman's ownership of the company, Sovereign, through Grossman, did not disclose the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements in Item 5.E of the Form ADV. (DX 83 at 8; DX 35 at 8; DX 78 at 8; DX 37 at 8; DX 38 at 8; DX 39 at 8; DX 40 at 8; DX 34 at 8.) In addition, Sovereign, through Grossman, represented (i) in Item 6.B(1) that Sovereign was not actively engaged in any business other than giving investment advice to clients; (ii) in Item 6.B(3) that Sovereign did not sell products or provide services other than investment advice to clients; and (iii) in Item 9, that Sovereign did not have a related person that had custody of its advisory clients' cash or securities. (DX 83 at 9, 12; DX 35 at 10, 13; DX 78 at 10, 13; DX 37 at 10, 13; DX 38 at 10, 13; DX 39 at 10, 13; DX 40 at 10, 13; DX 34 at 10, 13.)

38. These disclosures were misleading because: (i) Sovereign was in the business of referring its advisory clients to the Battoo Funds and PIWM; (ii) Sovereign, acting as an unregistered broker-dealer, received transaction-based compensation for selling securities in the Battoo Funds and PIWM; and (iii) by 2005, AH Florida had custody of Sovereign clients' investment funds. (DX 75; *see also* Tr. Vol. I at 224:22-25.) Prior to filing, Grossman reviewed and signed the aforementioned Form ADVs Part 1 on behalf of Sovereign, subject to the penalties of perjury. (Tr. Vol. II at 394:2-10, 15-20; 395:1-16; 397:12-17, 20-25; 398:1-11; 400:2-25; 401:1-5; 402:25; 403:1-25; 405:7-25; 406:1-4, 18-25; 407:1-16; 408:15-25; 409:1-15; 420:13-25; 421:1-11.) The first time Sovereign disclosed referral fees under the Referral and Consulting Agreements in Item 5.E of the Form ADV was in the ADV dated December 23, 2008 – ***after*** Grossman had sold Sovereign to Adams.[12] (DX 84 at 8.)

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[12] This disclosure, nevertheless, still was misleading. Among other reasons, Sovereign made the disclosure in response to questions on the ADV about its advisory business as opposed to more specific questions intended to elicit information about Sovereign's involvement in other business activities that could create potential conflicts of interest, such as the questions set forth in Items 7 and 8 of Form ADV Part 1.

39. During Grossman's ownership of Sovereign, the company's Form ADVs Part II either omitted, or contained misleading statements regarding, the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. For example, in Item 8 of its Form ADVs Part II dated May 1, 2003 and February 12, 2004, Sovereign, through Grossman, represented Sovereign did not have an arrangement with an investment company that was material to its advisory business or its clients. (GX 4 at 5; DX 131 at 4.) In Item 9, Sovereign, through Grossman, represented Sovereign did not recommend to clients that they buy or sell securities or investment products in which Sovereign or a related person [*i.e.*, SIAM LLC (an entity with common control)] had some financial interest. (GX 4 at 7; DX 131 at 5.) And in Item 13, Sovereign, through Grossman, represented that neither Sovereign nor a related person [*i.e.*, SIAM LLC (an entity with common control)] received additional compensation. (GX 4 at 8; DX 131 at 6.) In addition, on Schedule F, Sovereign, through Grossman, omitted any mention of the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. (DX 131 at 7.)

40. For each subsequent Form ADV Part II that was in effect during Grossman's ownership of the company, Sovereign, through Grossman, continued to make the same representations in Items 8, 9 and 13 described in the immediately preceding paragraph. (DX 77 at 4, 5, 6; DX 36 at 4, 5, 6; DX 40-1 at 7, 8, 9; DX 41 at 4, 5, 6; DX 34-1 at 4, 5, 6.) Additionally, Sovereign, through Grossman, stated on Schedule F of these subsequent Form ADVs Part II that: (i) Sovereign "may receive incentive or subscription fees from certain investment companies;" (ii) "may receive performance-based compensation from certain investment companies;" and (iii) Sovereign would "notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to [Sovereign]." (DX 77 at 8; DX 36 at 8; DX 40-1 at 11; DX 41 at 8; GX 7 at 2.)[13]

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[13] As discussed in more detail below, these disclosures on Schedule F of the subsequent Form ADVs Part II still were misleading. Even after Sovereign was examined by the Commission's Office of Compliance, Inspections and Examinations (OCIE), Sovereign and Grossman still were actually receiving fees and compensation under the Referral

Grossman reviewed each of the aforementioned Form ADVs Part II at the time they were prepared, and testified they were true and correct. (Tr. Vol. II at 396:10-16; 399:4-10; 401:22-25; 402:1-2; 410:9-15; 413:9-14; 422:3-9; Tr. Vol. III at 660:4-6.)

41. The statements on Schedule F of the subsequent Form ADVs Part II referenced in the immediately preceding paragraph that Sovereign "may receive incentive or subscription fees from certain investment companies," and "may receive performance-based compensation from certain investment companies" were misleading because, during the time these ADVs were in effect, SIAM LLC and Grossman ***actually were*** receiving fees and compensation under the Referral and Consulting Agreements. (DX 75.) In addition, despite representing otherwise in the ADVs, Grossman did not notify Sovereign clients of the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. (Tr. Vol. I at 39:13-17, 41:9-13, 62:1-25, 111:22-25, 123:19-25, 124:1-18; DX 152 at 75:1-25, 76:1-13; DX 50 at ¶ 7.) Notably, Gilluly testified at the hearing that Grossman did not disclose the Referral and Consulting Agreements to him or the fees and compensation SIAM LLC was being paid under the agreements. (Tr. Vol. II at 554:4-23.) After finding out about the fees and compensation, Sovereign clients considered them to be a conflict of interest. (Tr. Vol. I at 63:2-5.)

(iii) Misrepresentations and Omissions Concerning the Referral and Consulting Agreements in Sovereign's Investment Advisory Agreements

42. During Grossman's ownership of Sovereign, the company's investment advisory agreement ("IAA") either omitted, or contained misleading statements regarding, the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements.[14]

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and Consulting Agreements, and Sovereign clients testified at the hearing that Grossman never disclosed the fees and compensation to them.

[14] Notably, not all investors signed or even received an IAA at the time they became Sovereign clients. (DX 152 at 76:14-20.)

43. With respect to the initial IAA effective as of August 6, 2003, Sovereign, through Grossman, omitted ***any*** mention of the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. (DX 129.)

44. The revised IAA effective as of August 2006 contained statements similar to those in the Form ADVs Part II described above. The revised IAA stated that Sovereign "may receive performance-based compensation from certain investment companies," and would "notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to [Sovereign]." (DX 79 at 3.) These statements still were misleading because, during the time this IAA was in effect, SIAM LLC and Grossman ***actually were*** receiving fees and compensation under the Referral and Consulting Agreements. (DX 75.) In addition, these disclosures omitted any reference to transaction-based compensation, such as referral fees to SIAM LLC for recommending clients invest in certain funds. Moreover, despite representing otherwise in the IAA, Grossman did not notify Sovereign clients of the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. (Tr. Vol. I at 39:13-17, 41:9-13, 62:1-25, 111:22-25, 123:19-25, 124:1-18; DX 152 at 75:1-25, 76:1-13; DX 50 at ¶ 7.)

(iv) Misrepresentations and Omissions Concerning the Referral and Consulting Agreements in the Private Placement Memoranda and Subscription Agreements.

45. During Grossman's ownership of Sovereign, the private placement memoranda ("PPM") for the various classes of FuturesOne in which Sovereign clients invested made no reference to Sovereign, SIAM LLC or Grossman at all. (*See* DX 66, DX 67, GX 54, GX 55.) Accordingly, these materials did not disclose (and could not have disclosed) the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements.

46. Although PIWM was not a hedge fund and thus did not have its own private placement memorandum, the due diligence questionnaire and materials Grossman distributed to

Sovereign clients made no reference to Sovereign, Grossman or the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. (*See* GX 62, DX 50T, DX 69.) Accordingly, these materials did not disclose (and could not have disclosed) the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements.

47. During Grossman's ownership of Sovereign, the PPMs for the various classes of the Anchor Hedge Fund in which Sovereign clients invested made no reference to Sovereign or SIAM LLC at all. (*See* DX 25; DX 28; DX 29; GX 28; GX 30.) In addition, these PPMs did not disclose the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. (*See id.*)[15]

48. Moreover, the PPMs stated the 4.5% cost-of-entry fee under the various classes of the Anchor Hedge Fund would be used for purposes of "set up and distribution." (DX 25 at 18; DX 28 at 18; DX 29 at 18; GX 28 at 18; GX 30 at 18.) The PPMs did not disclose that instead of the stated purpose, Battoo actually paid the cost-of-entry fee to SIAM LLC under the Oral Agreement. (*See id.*) In addition, while the subscription agreements[16] referred to the 4.5% cost-of-entry fee, and provided the fee would be deducted from the client's investment, the subscription agreements also made no reference to the fact that Battoo paid the cost-of-entry fee to SIAM LLC. (DX 25 at 28; DX 28 at 27; DX 29 at 28; GX 28 at 28; GX 30 at 28.) Indeed, Gilluly (who acknowledged he was sophisticated with investing), testified he was aware of the cost-of-entry fee, which was a common fee for most hedge funds, but Grossman never disclosed to him that Battoo actually paid the fee to SIAM LLC. (Tr. Vol. II at 552:24-25; 553:1-5, 13-17; 530:20-22.)

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15 Grossman also told Sovereign clients he was a member of the investment advisory board of the Anchor Hedge Fund. (DX 152 at 51:2-12; DX 50 at ¶ 11.) He represented the same to FINRA in his disclosure report (DX 2 at 6) and also explicitly told OCIE staff in 2004 that he served as an investment advisor to the Anchor Hedge Fund. (GX 90 at 2.)

16 A subscription agreement is also known as an application for shares, and was included as part of the private placement memoranda. (Tr. Vol. II at 427:25; 428:1-4.)

49. The PPMs and subscription agreements, therefore, did not disclose (and could not have disclosed) the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements.[17] In addition, Grossman himself never disclosed to Sovereign clients that Battoo paid the 4.5% cost-of-entry fee to SIAM LLC under the Oral Agreement. (Tr. Vol. I at 61:10-25; DX 152 at 42:18-25, 43:1-3.) Grossman told clients the fee was a required "pay to play" fee that clients would pay directly to the fund. (Tr. Vol. I at 40:20-25; 41:1-2; 61:10-25).

50. Grossman reviewed each of the PPMs and subscription agreements for Anchor Hedge Fund and FuturesOne before recommending the investments to Sovereign clients. (Tr. Vol. II at 426:20-25; 427:1; 431:8-14; 433:17-23; 436:16-22; 438:16-22; 440:12-18; 442:8-14; 444:14-20.)

E. Grossman Misled Clients to Invest in the Anchor Hedge Funds

51. During his ownership of Sovereign, Grossman recommended Anchor Hedge Fund Classes A, B, C, E and I to Sovereign clients, almost exclusively. (Tr. Vol. I at 216:13-16; Tr. Vol. II at 354:4-11; 453:19-23; DX 50 at ¶ 16; DX 152 at 38:14-19; *see also* Answer ¶ 34.) These recommendations began approximately in August 2003. (Tr. Vol. I at 217:11-13; *see also* DX 23.) In written materials to clients, Sovereign described the strategy of the Anchor Hedge Fund as "deliver[ing] conservative gains, month over month and year over year, not to hit the 'homerun' with huge volatility swings." (DX 23 at 4.)[18] However, Grossman misrepresented the risk and independence of these funds.

(a) Cross Portfolio Liability.

52. The PPMs for Anchor Hedge Fund Classes A and B described the investments as moderately risky with goals of long-term capital appreciation and preservation. (DX 28 at 1-2; DX

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17 As an additional matter, not all Sovereign clients received PPMs for the Anchor Hedge Fund or FuturesOne at the time the clients made their investments. (DX 50 at ¶ 9.)

18 Sovereign also falsely stated to clients that despite Grossman's position as investment advisor to the Anchor Hedge Fund, Sovereign would not receive "additional compensation for recommending it." (DX 23 at 4.)

29 at 1-2.) Sovereign also described Classes A and B as having capital preservation as their primary goal. (DX 50F at 18-19.) 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 PPMs. Instead, the financial statements provided:

> Although the assets, liabilities and equity of each class are kept separate and segregated from the general assets of the [Anchor Hedge Fund], all of the assets of the Fund are available to meet all of the liabilities of the Fund, regardless of the class to which such assets or liabilities are attributable.

(DX 87 at 9; DX 88 at 9; DX 89 at 9.) 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 did not disclose the exposure between the classes to clients who sought only moderately risky investments. (DX 152 at 56:3-10.) In addition, there was no evidence presented at the hearing that Sovereign clients ever received the financial statements.

53. During Grossman's ownership of Sovereign, PIWM consisted of a series of underlying investments comprised of the Anchor Hedge Fund, FuturesOne, and the Galaxy Fund. (DX 69 at 12; DX 70.) Grossman was aware the Galaxy Fund was another of Battoo's funds, and thus the PIWM account itself was comprised entirely of Battoo funds. (Tr. Vol. I. at 274:11-13, 19-21.) Accordingly, the cross portfolio liability in the Anchor Hedge Funds described in the immediately preceding paragraph also impacted investments by Sovereign clients in PIWM.

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

54. 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. (Tr. Vol. I at 49:22-23, 50:25, 51:1-3; DX 152 at 32:15-19, 49:7-11.) Indeed, Grossman even described Class A as an investment for "widows and orphans." (DX 50 at ¶ 10.) According to the 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." (DX 28 at 1.) The PPM also stated Class A invested into a portfolio of market neutral equity hedge investing and other alternative investment funds, and that Class A would be independently administered by Folio Administrators, Ltd. ("Folio"). (DX 28 at 1, 5.) Moreover, Grossman described Class A in his book as being designed to "achieve capital preservation and appreciation." (DX 44 at 19.)[19]

55. The PPM for Class A did not disclose, however, that Folio was closely affiliated with Battoo and thus was not independent. In fact, the PPM listed Daniel Cann and Andrew Keuls as members of the board of the fund's investment manager (AHF Management). (DX 28 at 12.) However, Cann also was a member of Folio's board, the board of BC Capital Group (Battoo's entity), the board of Fiduciary Group Limited (the director of Class A), and the board of PIWM. (DX 28 at 12; DX 19 at 30; GX 13; GX 14; GX 62 at 2.) In addition, Keuls also was a member of the boards of BC Capital Group and PIWM. (DX 73 at 5; GX 62 at 2.) Accordingly, Cann was sitting on both sides of the table – on the one side, he was managing investments for Class A, and on the other, he was independently administering his own decisions. Grossman knew Cann and was aware he worked for Folio. (Tr. Vol. I at 212:14-18.)[20] He also knew Keuls worked for Battoo. (*Id.* at 213:8-14.)

56. Grossman provided other written materials to Sovereign clients, including PowerPoint presentations, that described Class A as a market neutral fund with minimal portfolio volatility and an investment objective "to achieve absolute annual returns of 10%-12% per annum." (Answer ¶ 38; *see also* DX 32 at 16; DX 33 at 19.) In addition, Grossman told Sovereign clients

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19 Sovereign provided clients with seemingly contradictory information about the various asset classes of the Anchor Hedge Fund. For example, Sovereign told one investor that Class C was the least risky of the asset classes. (Tr. Vol. I at 119:5-6, 12-14.)

20 In addition, the Referral and Consulting Agreements were signed either by Cann or Keuls. (*See* DX 71 at 5; DX 72 at 5; DX 73 at 5; DX 74 at 8.)

Class A was a safe fund with an outstanding return and track record over a number of years. (Tr. Vol. I at 49:22-23, 50:25, 51:1-3; DX 152 at 32:15-19, 49:7-11; DX 50 at ¶ 10.) Gilluly acknowledged at the hearing that he viewed Class A as a conservative investment. (Tr. Vol. II at 540:13-15.)

57. Contrary to Grossman's representations, Class A in fact did not invest in independently-administered and audited hedge funds. Grossman knew asset verification reports came from parties related to Battoo, not from independent third parties. According to the independent auditor's report for Class A, the director of Class A was responsible for authorizing the financial statements and asset verification reports and providing the data to the auditor. (*See* DX 90 at 9.) Fiduciary Group Limited was the director of Class A. (DX 28 at 5.) Cann served as a director of Fiduciary Group Limited (GX 13; GX 14), and, as noted above, also was a member of Folio's board and the boards of BC Capital Group (Battoo's entity) and PIWM. (DX 28 at 12; DX 19 at 30; GX 62 at 2.) Moreover, Fiduciary Group Limited shared the same address and post office box as Folio, the independent administrator of Class A. (*See* DX 28 at 5.)

58. Grossman reviewed the independent auditor's report and the PPM for Class A and thus was familiar with the interrelationship among Folio, Fiduciary Group Limited, Cann and Keuls. (Tr. Vol. II at 304:24-25; 305:1-4; 431:8-11). Despite this conflict of interest, however, Grossman still claimed to believe – remarkably – that the information Folio supplied was reliable because "an independent fund administrator's job is to determine if all the information related to the fund is accurate and the statistics are accurate." (Tr. Vol. III at 670:11-18.)

59. Grossman also knew the last independent auditor report Sovereign received for Class A was for the year ended December 31, 2007. (Answer ¶ 41; DX 90.) Battoo did not provide any other reports during Grossman's ownership of Sovereign. (*See id.*) And yet, Grossman continued to promote the Anchor Hedge Fund even after he became a consultant to Sovereign following the sale of the company to Adams. For example, in one email dated October 14, 2008, he told Sovereign

clients that "our hedge fund investments are 'fund of funds' that are highly diversified with different managers, styles, and strategies . . . It is very important to stay the course as these same funds will experience an incredible bounce. . . Patience will be rewarded." (DX 64 at 1.) In another email dated February 11, 2009, he promoted Sovereign's status as an SEC-registered investment advisor and told a prospective investor Sovereign had the capability to take the investor's plan offshore.[21] (DX 120 at 2.) And Grossman assured one Sovereign client that Class A remained a safe investment, even after the client's portfolio of Class A lost $900,000. (Tr. Vol. I at 50:25; 51:1-3.)

60. The investments in Class A also 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. (*See* DX 28.) Instead, many of the funds underlying the Anchor Funds were themselves comprised of other underlying funds. (Tr. Vol. I at 246:5-7.) Grossman himself even acknowledged that it was possible for the Anchor Funds ultimately to be invested in up to one hundred different funds. (*Id.* at 276:12-16.) 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. (DX 94 at 2.) The underlying funds were themselves invested in other underlying funds which turned out to be feeder funds into Madoff. (*See id.*; *see also* Tr. Vol. II at 486:2-8.)

61. During Grossman's ownership of Sovereign, Battoo periodically provided Grossman with the identity of the funds underlying the Anchor Hedge Fund. (Tr. Vol. I at 286:5-13.) Battoo sometimes presented the information to Grossman in the form of PerTrac reports, which contained a breakdown of the underlying funds in a pie chart format; at other times, Battoo discussed the underlying funds with Grossman. (*Id.* at 286:14-25; Tr. Vol. II at 325:25; 326:1-3.) Upon

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[21] As noted above, 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. (Tr. Vol. II at 453:19-23.)

receiving the information, Grossman claimed to research the underlying funds in the Barclays Hedge Fund database, which compiled statistical and other information about the funds.[22] (Tr. Vol. II at 320:20-25; 321:8-13.) Grossman claimed he researched the funds to learn as much information as possible about them because he did not want to recommend a fund of funds investment to a client, such as the Anchor Hedge Fund, without knowing what the underlying funds were. (*Id.* at 321:17-25.) And Grossman also explicitly represented to OCIE staff in 2004 that he performed "substantial due diligence on the underlying funds." (GX 90 at 2.)[23] Nevertheless, when questioned at the hearing, Grossman could not recall whether the composition of the underlying funds in the Anchor Hedge Fund changed during the time he owned Sovereign. (Tr. Vol. II at 333:19-25.)

62. At some point during Grossman's ownership of Sovereign, however, Battoo became evasive about the identity of the underlying funds. (Tr. Vol. II at 322:4-11.) Battoo began to claim the identity of the funds was proprietary, even though he had freely provided the information to Grossman in the past.[24] (*Id.* at 323:25; 324:2-4.) In fact, prior to the suspension of redemptions in Anchor Hedge Fund Class A on December 22, 2008, Grossman testified it had been "a while" since Battoo had provided him with information on the underlying funds. (*Id.* at 320:12-16.) This gap in

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22 As Grossman testified and the Law Judge acknowledged at the hearing, however, the Barclays database consists of self-reported information directly from the hedge funds, and is thus of minimal validity. (Tr. Vol. II at 343:4-9, 12.)

23 During the hearing, Grossman claimed he requested clarification from the administrator of the Anchor Hedge Fund that he was not, in fact, rendering investment advice to the fund. (Tr. Vol. I. at 256:1-4.) For reasons unknown to Grossman, the administrator did not provide the requested clarification until July 2008 and then again in July 2009. (GX 13; GX 14.) Meanwhile, Sovereign clients who invested in Anchor Hedge Fund before July 2008 believed Grossman was in fact an adviser to the fund. (DX 152 at 51:2-12; DX 50 at ¶ 11.) And materials about the Anchor Hedge Fund Grossman provided to Sovereign clients in the meantime continued to identify him as an advisor to the fund. (DX 31 at 8; DX 32 at 9; DX 33 at 9.) Grossman testified he reviewed these materials for accuracy before he sent them to clients. (Tr. Vol. I. at 266:20-24.) He acknowledged that had the materials been inaccurate, he would not have provided them to clients. (*Id.* at 266:25; 267:1-6.)

24 During the hearing, Grossman claimed on the one hand that Battoo's subsequent decision to regard the identity of the underlying funds as proprietary was consistent with the industry at that time, but Grossman conceded on the other hand that the industry norm did not apply to him because Battoo in fact had chosen to reveal the identity of the underlying funds to Grossman. (Tr. Vol. III at 843:18-25.) And Grossman himself claimed to have performed his own "substantial due diligence" on the underlying funds. (Tr. Vol. II at 348:2-9.)

time had an impact on Grossman because he claimed at the hearing the first time he had learned the underlying funds in Anchor Hedge Fund Class A were linked to Madoff was a day or two before he reviewed the letter from Anchor Hedge Fund suspending redemptions on December 22, 2008. (DX 94 at 2; Tr. Vol. II at 314:1-9.) And yet, up until 2008 when he sold Sovereign, Grossman claimed that he continued to perform "substantial due diligence" on the underlying funds when Battoo provided the information to him. (Tr. Vol. II at 348:2-9.) Despite the evasiveness from Battoo, and further despite claiming not to know what was happening with the underlying funds, Grossman continued to recommend investments in the Anchor Hedge Funds to clients. (*Id.* at 326:6.)

63. From 2003 until he sold Sovereign, Grossman, along with Battoo, were members of the investment advisory board of Anchor Hedge Fund Class A. (GX 25 at 5; DX 28 at 5.) As a member of the board and an investment adviser to Sovereign's clients, Grossman knew Class A did not invest in funds that were independently administered or audited, or diversified as described in the PPM. Grossman recommended clients invest (or remain invested) in Class A weeks after the sale of Sovereign to Adams. (DX 64 at 1; DX 120 at 2; Tr. Vol. I at 50:25; 51:1-3.)

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

64. 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 it was suspending redemptions of Class C because it was switching its portfolio from one bank to another. (DX 98 at 1.) This supposed change began at the end of 2007 but was delayed because of "deteriorating financial market conditions." (*Id.*) The letter also stated Anchor Hedge Fund would "begin processing redemptions as soon as it is practical." (*Id.*) Nevertheless, Grossman continued to advise Sovereign clients to invest or retain their investments in the Battoo Funds and PIWM. (DX 64 at 1; DX 93 at 1-2; DX 120 at 2; DX 113 at 2; DX 113-1 at 2; DX 151 at 1-2; Tr. Vol. I at 50:25, 51:1-3, 132:2-4.)

65. At the time Grossman sold Sovereign to Adams in October 2008, Grossman, who was a consultant to the Anchor Hedge Fund and a member of its investment advisory board, knew the Anchor Hedge Fund was not honoring requests for redemptions of Class C for June 30, 2008. (Tr. Vol. II at 340:11-25.) Indeed, internal Sovereign emails reflect that as of late September 2008 into the middle of October 2008, Sovereign still was waiting for redemptions in Class C.[25] (DX 99 at 1 ("We are waiting for his proceeds on Anchor C (as are all other clients that had redemptions in C for the quarter"); DX 100 at 1 ("If you could also provide an update on the redemptions that are still outstanding for 6/30/08 it would be greatly appreciated, as we have been getting daily calls from clients looking for their funds.") 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." (DX 64 at 1; *see also* DX 98 at 1.)

66. Grossman also continued to recommend PIWM (which, as noted above, consisted entirely of Battoo's funds, including Class C) to Sovereign clients at least as late as November 21, 2008. (DX 113 at 2; DX 113-1 at 2; Tr. Vol. I at 137:5-16; 160:18-21.) Grossman never told Sovereign clients redemptions of Class C were not being honored. (Tr. Vol. I at 139:9-12; DX 152 at 35:10-14; 89:1-10.)

67. Adams testified that before the sale of Sovereign, he suspected Grossman had deceived him because of the hold up in these redemptions. (Tr. Vol. II. At 478:8-13; 481:6-18.) Adams even noted that Battoo had told him Grossman was well aware of the hold up at the time he sold the company to Adams. (*Id.* at 481:6-18.)

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[25] Grossman was copied on these emails, but did not take the initiative himself to confirm the status of the redemptions.

F. Grossman Ignored Red Flags

68. Prior to the suspension of redemptions in Anchor Hedge Fund Classes A and C, Grossman failed adequately to research or investigate a number of red flags about Battoo and his funds. For example, as noted above, at the time Grossman sold Sovereign to Adams on October 1, 2008, Grossman knew the Anchor Hedge Fund was not honoring requests for redemptions in Class C for June 30, 2008. (Tr. Vol. II at 340:11-25.) Instead of questioning and investigating the failures to redeem and even after the Anchor Hedge Fund notified Sovereign of the suspension, Grossman continued to recommend the Anchor Hedge Fund and PIWM to clients. (DX 64 at 1; DX 93 at 1-2; DX 120 at 2; DX 113 at 2; DX 113-1 at 2; DX 151 at 1-2; Tr. Vol. I at 50:25, 51:1-3, 132:2-4.) Grossman never told Sovereign clients the Anchor Hedge Fund was not honoring redemptions of Class C. (Tr. Vol. I at 139:9-12; DX 152 at 35:10-14; 89:1-10.)

69. In addition, according to the PPMs for the Anchor Hedge Fund, shareholders were entitled to receive annual audited financial reports upon request. (*See* DX 25 at 26; DX 28 at 24; DX 29 at 25.) However, in 2008 Grossman knew Battoo had ceased providing to investors independently-audited financial statements regarding the Battoo Funds, as the last independent auditor report Sovereign received from Anchor Hedge Fund for Class C was for the year ended December 31, 2006, and for Anchor Classes A and B, for the year ended December 31, 2007. (Answer ¶ 41; DX 88; DX 90; DX 91.) Nevertheless, as noted above, Grossman continued to recommend the Battoo Funds and PIWM to Sovereign clients. (DX 64 at 1; DX 93 at 1-2; DX 120 at 2; DX 113 at 2; DX 113-1 at 2; DX 151 at 1-2; Tr. Vol. I at 50:25, 51:1-3, 132:2-4.)

70. Moreover, Anchor Hedge Fund PPMs also entitled investors to receive asset verification reports from independent third parties upon request. (*See* DX 25 at 26; DX 28 at 24; DX 29 at 25.) According to the PPMs, the funds' independent administrator, Folio, was tasked with preparing the reports. (DX 25 at 21; DX 28 at 20; DX 29 at 21.) However, as discussed above in

Paragraph 55, Grossman knew Folio was closely affiliated with Battoo and thus was not independent. In addition, Fiduciary Group Limited and Folio Management Services Ltd[26] shared the same address and post office box as Folio, the independent administrator of Classes A, B and C. (*See* DX 28 at 5; DX 29 at 5; DX 25 at 5.) Despite this lack of independence, undisclosed to investors, Grossman failed to investigate the figures Battoo provided to him. Instead, he touted the performance of the Battoo Funds to Sovereign clients. (DX 64 at 1; DX 93 at 1-2; DX 120 at 2; DX 113 at 2; DX 113-1 at 2; DX 151 at 1-2; Tr. Vol. I at 50:25, 51:1-3, 132:2-4.)

71. In addition, in the early 2000s, Grossman acted as IRA administrator for a number of clients who invested with Banyan Asset Management, a company unrelated to Sovereign. (Tr. Vol. II at 352:2-4.) Unfortunately, Banyan turned out to be a Ponzi scheme. (*Id.* at 350:24.25.) Based on that experience, Grossman claimed he became more cognizant of the investments he recommended to clients because he did not want to advise a client to invest in something that might end up being a Ponzi scheme (such as Madoff). (*Id.* at 353:12-21.)

72. As a result of Grossman's misconduct described herein, Sovereign clients sustained significant losses on their investments. (Tr. Vol. I at 86:18-25; Tr. Vol. II at 556:22-25, 557:14-16; DX 50 at ¶¶ 26, 32; DX 152 at 111:1-8.)

G. The 2004 Examination of Sovereign

73. OCIE examined Sovereign beginning in October 2004. (Tr. Vol. IV at 936:5-7.) The two experienced examiners who conducted the exam, and served as Sovereign's point of contact, were Jesse Alvarez and Tonya Tullis. (*Id.* at 935:19-22; 936:1-4.) Between them, they have conducted more than 100 examinations of investment advisers and investment companies. (Tr. Vol. IV at 925:4-11; 955:24-25; 956:1-2, 8-12.) In addition, both Alvarez and Tullis maintain the Certified Fraud Examiner (CFE) designation. (*Id.* at 924:17-20; 955:15-18.)

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[26] Folio Management Services Ltd. ("FMS") was the director of Anchor Hedge Fund Class C. (DX 25 at 5.)

74. Following the examination, OCIE determined that deficiencies existed in Sovereign's various disclosure documents, including its IAA and Form ADV Part II. (Tr. Vol. IV at 937:18-20.) OCIE sent Sovereign a letter on February 7, 2005, outlining the extent of the deficiencies (the "Deficiency Letter"). (DX 141.) OCIE determined that because Battoo actually was paying fees and compensation to SIAM LLC under the Referral and Consulting Agreements, Sovereign's then-existing disclosures in its IAA (DX 129) and Form ADV Part II (DX 131; GX 4) were misleading. (*See* DX 141 at 1, 4.) OCIE recommended that Sovereign either comply with the language of its then-existing IAA and cease receiving the fees and compensation, or amend the agreement to disclose the receipt. (Tr. Vol. IV at 939:10-13.) OCIE also stated in the final sentence on the first page of the Deficiency Letter that "[Sovereign] may also need to amend its ADV Part II to disclose the receipt of performance based compensation." (DX 141 at 1.) Alvarez testified at the hearing the quoted sentence was conditional – *i.e.*, ***if*** Sovereign elected to revise its IAA to disclose the fees and compensation, then it also would need to amend its Form ADV Part II to make the same disclosure. (Tr. Vol. IV at 939:18-25.) As part of its practice, OCIE left the decision to Sovereign on how to correct the deficiencies, and the choice ultimately rested with Grossman on which option he wanted to use. (*Id.* at 940:8-15.)

75. Sovereign responded to the Deficiency Letter on March 8, 2005. (DX 142.) Among other things, Grossman stated in the response that Sovereign had amended its IAA and Form ADV Part II "to more accurately reflect the various ways [Sovereign] may receive compensation." (*Id.* at 1.) The response did not indicate, however, ***how*** the documents were amended. While OCIE staff received the response, they did not review the amendments because, as Alvarez testified, that is not OCIE's function. (Tr. Vol. IV at 943:6-11.) OCIE closes its examination following receipt of the response, and does not review or test the sufficiency of the corrective action that a registrant claims it will take or has taken. (*Id.* at 943:14-18.)

76. Grossman testified at the hearing that OCIE staff instructed him in the Deficiency Letter that he should use the word "may" in connection with correcting the disclosures in the IAA and the Form ADV Part II – *viz.*, Sovereign "may receive incentive or subscription fees from certain investment companies," and "may receive performance-based compensation from certain investment companies." (Tr. Vol. III at 856:18-23.) When questioned further as to which part of the Deficiency Letter instructed him to use that specific language, Grossman pointed to the last paragraph on the first page of the Deficiency Letter, and quoted the final sentence "[Sovereign] may also need to amend its ADV Part II to disclose the receipt of performance based compensation." (DX 141 at 1; Tr. Vol. III at 857:15-25.) As noted above, however, that sentence did not mean what Grossman claimed.

77. At the hearing, Grossman also claimed he provided a preliminary written response (GX 85) to the examiners before Sovereign received the Deficiency Letter. (Tr. Vol. III at 830:8-13.) When questioned further, however, Grossman could not recall details about the letter, such as whether he provided it to the staff in person or whether he sent it after the on-site portion of the exam concluded; which examiner he discussed the response with; and when he discussed or provided the response. (*Id.* at 830 at 11-13; 831:15-25; 832:5-6, 13-20.) In the written response, among other things, Grossman indicated Sovereign would work with National Regulatory Services to assist the company in revising its compliance materials. (DX 85 at 1.) In addition, Grossman indicated Sovereign would modify its disclosures to state that "Sovereign may from time to time receive commissions and or other fees on certain investments." (*Id.*) In a situation like this, it is OCIE's practice to advise a registrant, like Sovereign, that the staff cannot approve or disapprove of any intended actions the registrant plans to take. (Tr. Vol. IV at 934:11-12; 958:15-16.) OCIE also instructs the registrant that the staff cannot provide any advice or guidance on how to correct the deficiencies, and that the registrant should wait until a deficiency letter is provided, as any findings

discussed with the registrant prior to the deficiency letter would only be preliminary. (*Id.* at 934:15-18; 958:15-24.)

78. Grossman also claimed at the hearing that the examiners orally told him during the exam it would be acceptable to use the word "may" in connection with the disclosures. (Tr. Vol. III at 860:14-18.) When questioned further, however, Grossman could not recall which examiner told him that nor could he recall the circumstances of the conversation, remarking that "it was ten years ago." (*Id.* at 860:23-25; 861:1-5.) And both Alvarez and Tullis testified they did not instruct Grossman or anyone at Sovereign to use that word. (Tr. Vol. IV at 943:23-25; 944:1-4; 961:22-25; 962:1-4.) Indeed, it is not OCIE's function to provide such advice or guidance to a registrant on how to correct deficiencies. (*Id.* at 930:9-17; 962:5-13.) Instead, OCIE leaves it to the registrant to determine for itself how to make the corrections. (*Id.* at 930:18-21.) Registrants are free to consult counsel or a securities professional of their choosing to assist in the process.[27] (*Id.* at 935:2-6.)

79. As noted above, the revisions Sovereign made to its subsequent IAA and Form ADVs Part II following OCIE's examination continued to be misleading, because Sovereign and Grossman ***still actually were*** receiving fees and compensation under the Referral and Consulting Agreements, and Sovereign clients testified at the hearing that Grossman never disclosed the fees and compensation to them. (Tr. Vol. I at 39:13-17, 41:9-13, 62:1-25, 111:22-25, 123:19-25, 124:1-18; Tr. Vol. II at 554:4-23; DX 152 at 75:1-25, 76:1-13; DX 50 at ¶ 7.)

80. In addition, the evidence presented at the hearing showed the first time Sovereign made these revisions in an attempt to correct the disclosure deficiencies was not until the Form ADV Part II that Sovereign prepared on August 22, 2006, and the IAA that Sovereign prepared

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[27] The Division notes an example of such a securities professional is National Regulatory Services, the entity Grossman identified in his preliminary response letter. (DX 85; *see also* Tr. Vol. IV at 949:9-17.) Grossman therefore had a professional in mind at the time the Deficiency Letter was prepared.

in August 2006. (Tr. Vol. III at 851:16-24; 866:7-20.) This was approximately 18 months after the examination of Sovereign was completed in February 2005.[28]

81. Following the examination, Grossman never requested a "no action" letter from the Commission concerning his attempt to correct the disclosure deficiencies with respect to the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements. (Tr. Vol. II at 350:7-13.)

III. LEGAL DISCUSSION

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

1. Section 17(a)(2) of the Securities Act makes it unlawful to use the means or instrumentalities of interstate commerce 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; instead, the Division need only show negligence. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980). As noted below, however, Grossman knowingly made the misrepresentations and omissions to investors. 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.[29]

2. Grossman obtained money or property by means of material misrepresentations and omissions, in the offer or sale of securities within the meaning of Section

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[28] Grossman acknowledged a Form ADV II must be amended as soon as a registrant encounters a material change in its prior disclosures. (*Id.* at 847:18-21.)

[29] In reality, however, as noted above, the overwhelming majority of Sovereign clients actually did purchase the Battoo Funds and PIWM. (PFF at 27.) The Division will cite to its Proposed Findings of Fact set forth in Section II above as "PFF at __."

17(a)(2) of the Securities Act. Specifically, from late 2003 through late 2008, Grossman failed to disclose to Sovereign clients that he received fees and compensation under the Referral and Consulting Agreements each time a Sovereign client invested in the Battoo Funds and PIWM, and also failed to disclose conflicts of interest among the administrator and manager of the Anchor Hedge Funds while offering or selling securities in the Battoo Funds and PIWM. (PFF at 26-50, 55.) Grossman used the means and instrumentalities of interstate commerce, through telephone, email, wire transfers, and the company's website, to obtain client investment funds and provide materials about the Battoo Funds and PIWM to Sovereign clients in the course of offering those securities; Grossman knew these materials omitted any disclosure of the fees and compensation he received; and Battoo paid the fees and compensation to the Jyske Bank account through checks and wire transfers. (*Id.* at 10-11, 13-14, 15, 17-19, 23, 27, 35; *see also* DX 75.) Grossman also knowingly made false and misleading oral and written statements to Sovereign clients concerning the safety, diversification, and performance of the investments in the Battoo Funds. (*Id.* at 51-72.) These misstatements and omissions were material to Sovereign clients because they viewed Grossman's compensation as a conflict of interest and would not have invested in the Battoo Funds and PIWM had they known of the conflict and had Grossman accurately described the risk and diversification of these funds. (*Id.* at 41.)

B. Grossman 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

3. Grossman violated the Advisers Act from at least August 2003 through November 2008.

(a) Sovereign and Grossman Were Investment Advisers

4. Sovereign was registered with the Commission as an investment adviser. (PFF at 2.) 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 also meets this definition and may be charged as a primary violator of the Advisers Act's antifraud provisions because he wholly owned Sovereign, controlled Sovereign, and was in the business of providing investment advice for management and performance compensation. *In the Matter of John J. Kenny and Nicholson/Kenny Capital Management, Inc.*, AP File No. 3-9611, Advisers Act Release No. 2128, 2003 SEC LEXIS 1170, at *63 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)).

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

5. 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 its clients. *Laird v. Integrated Resources, Inc.*, 897 F.2d 826, 833 (5th Cir. 1990); *SEC v. Blavin*, 760 F.2d 706, 711-12 (6th Cir. 1985) (citing *Capital Gains*, 375 U.S. at 194 and n.44).

6. 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.

7. 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); *SEC v. Mannion*, 789 F. Supp. 2d 1321, 1339 (N.D. Ga. 2011).

a. Grossman's Misrepresentations and Omissions

8. 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.*, AP File No. 3-9042, 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

9. Grossman recommended the Battoo Funds and PIWM to Sovereign clients in exchange for substantial referral fees from Battoo, which Grossman received until approximately late 2008. (PFF at 28-35.) Receiving compensation from Battoo created conflicts of interest between Grossman and his clients. As an investment adviser, Grossman had an obligation to put his clients' interests ahead of his own. In breach of his fiduciary obligation, he used client assets to benefit himself financially and compromised his ability to evaluate independently whether to recommend, or to keep, the Battoo Funds and PIWM as investments for his clients. Grossman failed to disclose this conflict and recommended almost exclusively that clients invest, or stay invested, with the Battoo Funds and PIWM. (*Id.* at 26-50.) In fact, the fees Grossman solicited were contrary to disclosures Sovereign and Grossman made to clients about his compensation, such as in Sovereign's Form ADV Part II, including statements that Sovereign would notify clients of "any and all fees" paid to their advisers. (*Id.* at 36-50.) By intentionally not disclosing his arrangements with Battoo in breach of his fiduciary duties, Grossman violated Sections 206(1) and 206(2).

10. Indeed, contrary to Grossman's position throughout this proceeding, not only did the Commission and OCIE not sanction the use of the word "may" in Sovereign's corrected disclosures in its IAA and Form ADV Part II following the examination in 2004, the word itself is still misleading as a matter of law because Sovereign actually was receiving fees and compensation under the Referral and Consulting Agreements. (PFF at 78-79.) In fact, numerous courts previously have held that the word "may" when used as a substitute for the fact that a party actually ***is*** receiving a fee 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*, AP File No. 3-9201, Release No. 8102, 2002 WL 1315552, at *11 (May 17, 2002).

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

11. As a member of Anchor Hedge Fund's Investment Advisory Board, Grossman knew 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 and reviewed;

- 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 because Grossman knew the asset verification reports came from parties related to Battoo and Grossman knew Battoo became evasive and ceased providing information about the composition of the underlying funds, and Grossman thus acted recklessly in continuing to promote the Anchor Hedge Funds to Sovereign clients; and

- Although Grossman knew Anchor Class C 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.

(PFF at 51-67.) In addition, 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 Sovereign clients.

b. Failure to Perform Due Diligence and Investigate Red Flags

12. Grossman also violated Sections 206(1) and 206(2) when he 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 to clients. (PFF at 68.) And he knew Battoo had ceased providing independently-audited financial statements regarding the Battoo Funds. (*Id.* at 69.) Yet, Grossman continued to recommend the Battoo Funds and PIWM to Sovereign clients. His conduct, in light of his duties and obligations as an investment adviser, was severely reckless. Indeed, given the conflict of interest that existed between the administrator and officers of the Anchor Hedge Fund and given Battoo's continued evasiveness as to the identity of the underlying funds, Grossman was required to do more than simply take the information Battoo gave him at face value because an 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

SEC v. Blavin, 557 F. Supp. 1304, 1314 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985).

13. 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*, AP File No. 3-6322, 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*, AP File No. 3-13454, Advisers Act Release No. 2871 (Apr. 22, 2009) (investment adviser owes fiduciary duty to conduct due diligence as represented).

(c) Grossman Violated Section 206(3) of the Advisers Act

14. Section 206(3) of the Advisers Act makes it unlawful for an investment adviser acting as broker for a third party other than the adviser's own client to knowingly sell or purchase any security from the third party for the client, without first disclosing to the client in writing before the completion of such transaction the capacity in which the adviser is acting and obtaining the consent of the client to such transaction.

15. Section 206(3) does not require a showing of scienter. *In the Matter of Marc N. Geman*, AP File No. 3-9032, Advisers Act Release No. 1924, 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, 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.*

16. During his ownership of Sovereign, Grossman was the sole or majority owner of Sovereign, AH Florida, AH Nevis, and SIAM LLC. (PFF at 2-5.) He received transaction-based compensation, through SIAM LLC, from the Battoo-related entities for purchases of the Battoo Funds and PIWM. (*Id.* at 28-35.) Grossman violated Section 206(3) when, as an investment adviser, he knowingly effected the sale of the Battoo Funds and PIWM to Sovereign clients without (i) providing adequate written disclosures that he was acting as a broker 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).

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

17. 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). *SEC v. Steadman*, 967 F.2d 636, 647 (D.D.C. 1992); *see also Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, Advisers Act Release No. 2628, 72 FR 44576 (Aug. 3, 2007).

18. 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.[30] 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 statements 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 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).

19. 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.*, No. 10-cv-577, 2011 U.S. Dist. LEXIS 97821, at *18-19 (S.D. Fla. Aug. 31, 2011). The knowledge requirement can be satisfied by extreme

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[30] 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 herein.

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*, AP File No. 3-13387, Advisers Act Release No. 2849, 2009 SEC LEXIS 501, at *11 (Mar. 2, 2009).

20. Here, from 2005 until October 2008, Sovereign, through Grossman, 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. (PFF at 15-20.) As a result, Sovereign, through Grossman, 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)). Here, clients received no statements from qualified custodians or Sovereign regarding their money invested through AH Florida. (PFF at 18.) 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. (*Id.*) Accordingly, Sovereign violated Rule 206(4)-2. Grossman aided and abetted the violation because, as Sovereign's sole control person, he was responsible for and effectuated the pooling of client funds in AH Florida, and he knew Sovereign clients were not receiving the required statements and also knew Sovereign did not undergo the required audit. (*Id.* at 18-20.)

(e) Grossman Violated Section 207 of the Advisers Act

21. 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.").

22. 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 December 23, 2008 – ***after*** Grossman had sold Sovereign to Adams. (PFF at 38.) 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]." (*Id.* at 40.) As described above, however, Grossman never notified Sovereign clients of any fees. (*Id.* at 41.) And Part II of the ADV never mentioned any referral fees or transaction-based compensation despite containing a specific box, which Grossman never checked, to disclose receipt of "some economic benefit from a non-client in connection with giving advice to clients." (*Id.* at 40-41.) Grossman signed Sovereign's Form ADV Part 1 which contained material omissions and misstatements concerning, among other things, compensation and conflicts of interest. (*Id.* at 38.)

23. Accordingly, Grossman 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.*, AP File No. 3-9243, Advisers Act Release No. 1614, 1997 SEC LEXIS 304, at *10-11 (Feb. 10, 1997) (settled order finding adviser and adviser's president, who signed false Form ADVs, violated Section 207).

(f) Grossman Aided and Abetted and Caused Violations of Advisers Act Rule 204-3

24. 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. (PFF at 36.) Grossman aided and abetted the violation because, as Sovereign's sole control person, he was responsible for reviewing and providing the brochure to Sovereign clients and was reckless in not ensuring that all clients had received the form.

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

25. 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-cv-8540, 1990 WL 918812, at *8 (S.D. Fla. May 18, 1990).

26. 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 ***non-exclusive*** 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-cv-

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).

27. Here, Grossman willfully violated Section 15(a) of the Exchange Act by acting as a broker while not registered as such with the Commission and while not an associated person of a broker or dealer registered with the Commission.[31] Grossman actively solicited investors and selected a portfolio for them based on what he claimed were discussions about the clients' investment objective. (PFF at 11-13.) In reality, however, aside from *de minimis* investments in non hedge funds, the portfolio consisted exclusively of the Battoo Funds and PIWM. (*Id.* at 13.) In return for his promotion of, and referring Sovereign clients to, the Battoo Funds and PIWM, Grossman received commissions and transaction-based compensation from Battoo under the Referral and Consulting Agreements for each investor that invested in the Battoo Funds and PIWM. (*Id.* at 28-35; *see also* GX 85 at 1 (acknowledging Sovereign's receipt of commissions)). By acting as an unregistered broker-dealer in offering the Battoo Funds and PIWM, Grossman violated Section 15(a) of the Exchange Act. Moreover, he aided and abetted and caused Sovereign's and SIAM LLC's violations.

D. Grossman's Affirmative Defenses

28. 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 hearing, but struck the defense of estoppel as improper.

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[31] Indeed, nobody at Sovereign was an associated person of a broker or dealer registered with the Commission. (PFF at 9.)

(a) Assuming the Statute of Limitations is Applicable to this Proceeding, It Would Apply Only to the Division's Civil Penalty Claim

29. The Division notes that Grossman's statute of limitations defense is substantively without merit. Assuming, however, 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, cease-and-desist order and industry bar. *See, e.g., In the Matter of Prime Capital Services, Inc.*, AP File No. 3-13532, 2010 SEC LEXIS 2086, at *9 (2010) (disgorgement and cease-and-desist orders are not subject to 28 U.S.C. § 2462); *In re Carley et al.*, AP 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"); *In the Matter of Moskowitz*, AP File No. 3-9435, 2002 SEC LEXIS 693, at *45 (Mar. 21, 2002) (industry and associational bars are not subject to 28 U.S.C. § 2462); *SEC v. Monterosso*, No. 13-cv-10341, 2014 WL 815403, *7 (11th Cir. Mar. 3, 2014) ("Disgorgement is an equitable remedy intended to prevent unjust enrichment."); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (disgorgement is remedial, not punitive, and not subject to 28 U.S.C. § 2462); *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); *SEC v. Des Champs*, Case No. 08-cv-01279, 2009 U.S. Dist. LEXIS 92801, at *5 (D. Nev. Sept. 21, 2009) (equitable claims such as injunctive relief, disgorgement and officer and director bars are not subject to 28 U.S.C. § 2462); *SEC v. Schiffer*, Case No. 97-cv-5853, 1998 U.S. Dist. LEXIS 6339, at *8-9 (S.D.N.Y. May 5, 1998) (industry and associational bars are not subject to 28 U.S.C. § 2462).

30. In his Prehearing Brief, Grossman cites *SEC v. Microtune, Inc.*, 783 F. Supp. 2d 867 (N.D. Tex. 2011), as support for his argument that the Division's equitable claims for

disgorgement, prejudgment interest, a cease-and-desist order and industry bar rise to the level of a penalty and therefore are time-barred under 28 U.S.C. § 2462. This argument is without merit. The district court in *Microtune* held that equitable claims for injunctive relief and officer-and-director bars[32] can constitute a penalty where the facts show such remedies (i) would have significant collateral consequences on a defendant's profession, (ii) do not address past harm caused by the defendant, and (iii) are not focused on preventing future harm due to the low likelihood the defendant would engage in similar behavior in the future. *Id.* at 885. The facts in this proceeding, however, are readily distinguishable. First, by his own admission, Grossman no longer renders investment advice through his company, SIPS, and acts solely as an IRA administrator. Second, and as a result of the first, the Division's requested cease-and-desist order and industry bar are designed to remedy the past harm caused by Grossman when he did act as an investment adviser through Sovereign. And third, because Grossman continued to act as an investment adviser, even after he sold Sovereign to Adams, the cease-and-desist order and industry bar are necessary to prevent him from engaging in such overlapping behavior in the future through his work for SIPS.

31. Grossman also argues in his Prehearing Brief that the Supreme Court's decision in *Gabelli* applies to the Division's equitable claims for disgorgement, prejudgment interest, a cease-and-desist order and industry bar. Grossman completely misstates the *Gabelli* opinion.

32. *Gabelli* addressed the limited issue of whether the discovery rule serves to toll the five-year statute of limitations applicable to civil penalties under 28 U.S.C. § 2462. *Gabelli*, 133 S. Ct. at 1219. No other issue was before the Supreme Court, and the Court even confirmed this by noting in dicta that it was not deciding the application of 28 U.S.C. § 2462 to injunctive relief and disgorgement. *See id.* at 1220 n.1. Moreover, courts since *Gabelli* have held unequivocally that 28 U.S.C. § 2462 does not apply to equitable claims. *See, e.g., SEC v. Geswein*, Case No. 10-cv-1235,

[32] The Division notes that it is not seeking an officer-and-director bar in this proceeding, only an industry or associational bar.

2014 WL 861317 (N.D. Ohio Mar. 5, 2014) (declining to revisit pre-*Gabelli* holding that 28 U.S.C. § 2462 did not apply to disgorgement); *SEC v. Syndicated Food Serv. Int'l, Inc.*, Case No. 04-cv-1303, 2014 U.S. Dist. LEXIS 42532, at *59 (E.D.N.Y. Feb. 14, 2014) (noting *Gabelli* does not apply to equitable claims for injunctive relief or disgorgement).

(b) Grossman Engaged in Misconduct that Falls Within the Five-Year Period Set Forth in 28 U.S.C. § 2462

33. The evidence the Division introduced at the hearing demonstrates Grossman engaged in misconduct that falls within the five-year period set forth in 28 U.S.C. § 2462. The Division's civil penalty claim therefore is timely.

34. Following the sale of Sovereign to Adams, and until at least March 23, 2009, Grossman continued to play an active role in running the company and providing direct investment advice to clients. In particular, he continued to be listed as an associated person in Sovereign's Form ADV Part II, dated October 30, 2008. (PFF at 23.) In addition, Sovereign clients testified at the hearing that Grossman worked with them on their investments in mid-October 2008 and January 2009 and continued to serve as, and represented that he remained, their investment advisor. (*Id.*) Sovereign clients also testified that Grossman: (i) reached out to them in mid-October 2008 to supplement client files; (ii) made specific investment recommendations to them on November 21, 2008; and (iii) worked with them on the status of their Anchor Hedge Fund investments after November 18, 2008 and into 2009 (DX 152 at 104:15-21; DX 152 at Ex. 15). These activities led Sovereign clients to believe Grossman remained their investment advisor. (*Id.*) Adams acknowledged at the hearing that he was not present during every phone call or conversation Grossman had with clients, so Adams was unaware of whether Grossman was telling clients, after the sale of Sovereign or even later in 2009, to retain their investments in the Battoo Funds and PIWM. (*Id.*)

35. Moreover, Adams testified Grossman remained on the Sovereign payroll as a paid consultant, assisting Adams with the transition of Sovereign's business and client relations, and

received a paycheck as late as March 23, 2009. (PFF at 38.) Adams also testified that in 2009, when Battoo completed an audit of investments in PIWM, Battoo shared and discussed the audit with Grossman, but not with Adams, even though at the time of the audit, Grossman already had sold Sovereign to Adams. Grossman also promoted Sovereign's status as an SEC-registered investment advisor and told a prospective investor on February 11, 2009 that Sovereign had the capability to take the investor's plan offshore. (*Id.*) Grossman continued to assist Adams as an investment adviser as late as February 19, 2010, and Grossman and Adams planned, as late as December of 2010, to meet on a weekly basis to discuss Sovereign's operations. (*Id.*)

36. Finally, following the sale of Sovereign to Adams, SIPS continued to act as an IRA administrator for Sovereign's clients. (PFF at 24.) Also, after November 21, 2008 and into 2009, while Grossman was engaged in the conduct described in Paragraphs 34-35 above, SIPS: (i) continued to share the same computer system as Sovereign, with joint control of each company's files and client information, and the ability to access data entries and even change them subsequently; (ii) interchanged employees, with SIPS employees performing Sovereign functions and Sovereign employees performing SIPS functions; and (iii) shared office space. (*Id.*) In fact, during that time period, a prospective client entering the Sovereign/SIPS office would have no way of telling what was Sovereign and what was SIPS unless they asked. (*Id.*)

37. These facts clearly show Grossman continued to play an active role in running Sovereign and providing direct investment advice to clients. The OIP was filed on November 20, 2013. As the Division's evidence demonstrates, however, Grossman's misconduct continued beyond five years before that, or November 20, 2008. Accordingly, any of Grossman's misconduct that predates November 20, 2008 may be viewed as part of a continuing, interrelated scheme to defraud investors, which would satisfy the "continuing violation" exception to the statute of limitations. *See In the Matter of Simpson*, AP File No. 3-9458, 1999 SEC LEXIS 1908, at * 116-17 (Sept. 21, 1999).

That exception provides that if an unlawful practice commences prior to the limitations period but continues into the period, the five-year statute under 28 U.S.C. § 2462 is measured from the time the unlawful practice ends within the period. *SEC v. Kovzan*, Case No. 11-cv-2017, 2013 U.S. Dist. LEXIS 147947, at *6 (D. Kan. Oct. 15, 2013). The doctrine applies to an ongoing fraud that, as here, goes beyond isolated misrepresentations and is a continuous, integrated scheme. *Id.* at *9; *SEC v. Kelly*, 663 F. Supp. 2d 276, 288 (S.D.N.Y. 2009). The evidence demonstrates that Grossman continued to perpetrate his fraudulent activities well into the limitations period, and even remained on the Sovereign payroll more than four months after the five-year period began. This is sufficient to invoke the "continuing violations" exception to 28 U.S.C. § 2462, and the Law Judge therefore should properly determine that ***all*** of Grossman's misconduct, even the misconduct predating November 20, 2013, should constitute part of the civil penalty to be imposed on him.

38. Assuming, however, the Law Judge were to find that the "continuing violations" exception does not apply, then, as the Law Judge correctly observed at the prehearing conference on March 7, 2014, the Law Judge may still consider misconduct predating November 20, 2013 as relevant for purposes of disgorgement and the sanctions to be imposed. *See id.*; *see also Carley*, 2008 SEC LEXIS at * 86-87; *Prime Capital Services, Inc.*, 2010 SEC LEXIS at *8 (2010) (misconduct that falls outside the five-year period can still be considered for purposes of determining the appropriate sanction to impose).

(c) Grossman's Estoppel Defense is Improper

39. 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*, No. 91-cv-6785, 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, 422 (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. And the Law Judge therefore properly struck Grossman's estoppel defense as a matter of law.

40. At the hearing, however, the Law Judge permitted the parties to introduce evidence of the OCIE examination to determine whether, as a matter of fact, the Division would be unable to proceed with its claims either (i) because of OCIE's inaction following the exam; or (ii) because OCIE misrepresented the corrective action Grossman needed to take. Grossman did not introduce any evidence at the hearing to substantiate either iteration of this theory. Instead, the Division introduced evidence specifically contradicting both of these theories.

41. As a preliminary matter, however, the Division notes that regardless of the evidence introduced at the hearing, Law Judges of the Commission 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., In the Matter of Newbridge Securities Corp. et al.*, AP 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"); *In the Matter of William H. Gerhauser*, AP 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"); *In the Matter of Steven C. Pruette*, AP File No. 3-5108, 46 S.E.C. 1138, 1141 (1978) (same). In addition, a respondent must plead and prove a "definite misrepresentation of fact to another person." *In the Matter of Alderman et al.*, AP File No. 3-15127, 2013 SEC LEXIS 351, at *13 (Feb. 1, 2013).

42. At the hearing, Grossman could not identify a single specific misrepresentation that either of the OCIE examiners made to him, orally or in writing. Instead, his entire defense was based on use of the word "may" in his revised disclosures, which he contended OCIE instructed him to use. When questioned further at the hearing, it became apparent that Grossman misconstrued the Deficiency Letter. Grossman pointed to the last paragraph on the first page of the Deficiency Letter, and quoted the final sentence "[Sovereign] may also need to amend its ADV Part II to disclose the receipt of performance based compensation." (DX 141 at 1; Tr. Vol. III at 857:15-25.) Grossman, however, took the final sentence out of context. As the examiners testified, that sentence meant that ***if*** Sovereign chose to amend its IAA to disclose the fees and compensation paid to SIAM LLC under the Referral and Consulting Agreements, then it also needed to amend its Form ADV Part II to make the same disclosure. (PFF at 74.) This is hardly a definite misrepresentation of fact by the examiners.

43. The Division's evidence showed that following the examination, OCIE determined deficiencies existed in Sovereign's various disclosure documents, including its IAA and Form ADV Part II. (PFF at 74.) OCIE provided the Deficiency Letter to Sovereign, and gave Grossman the option either to cease receiving the fees and compensation under the Referral and

Consulting Agreement, or to revise Sovereign's IAA and Form ADV Part II to disclose the fees and compensation to Sovereign clients. (*Id.*) Grossman elected not to stop receiving the fees and compensation, but instead of properly disclosing the information in the documents, he used the word "may," which, as noted above, is nothing more than a misleading "half-truth." Accordingly, the Division's evidence showed not only that Sovereign's disclosures to clients were misleading prior to the 2004 examination, but also continued to be misleading even after Grossman revised the disclosures in the years following the examination. (*Id.* at 73-80.)

44. The evidence also showed that when Grossman allegedly told the examiners before the Deficiency Letter was sent that he planned to use the word "may" in his revised disclosures, the examiners acted within established OCIE practice and advised Grossman they could not approve or disapprove of any intended actions he planned to take. (PFF at 78.) They also told him to consult with his own securities professional or counsel, such as National Regulatory Services, whom Grossman himself claimed to have retained. (*Id.*)

45. Accordingly, Grossman's estoppel defense, both as a matter of law and as a matter of fact, is improper, and the Law Judge therefore should reject it.

IV. REMEDIES

A. Disgorgement and Civil Penalties Are Appropriate

46. 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[33] violated, or aided or abetted a violation of, any

[33] In this context, "wilfully" means a respondent intended only to do the underlying acts that constituted the violations, not that he knew he was violating or intended to violate the law. *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.

provision of the Securities Act, Exchange Act, Advisers Act or the Investment Company Act, and a penalty is in the public interest.

(a) Disgorgement

47. The Division showed at the hearing Grossman violated the federal securities laws. The Division also showed Grossman profited from his illegal conduct in the amount of $3,407,765.66 in fees and compensation under the Referral and Consulting Agreements. (PFF at 35.) Under the circumstances, it would be inequitable to allow Grossman to keep those proceeds.

a. Legal Standards

48. Disgorgement is designed both to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws. *See Blatt*, 583 F.2d at 1335; *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 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).

49. 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.

50. The Division presented evidence at the hearing demonstrating that Grossman 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 amount of $3,407,765.66.

51. In addition to disgorgement, prejudgment interest is equitable in these circumstances. Grossman has enjoyed access to his 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.[34] The rate of interest "reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from [the] fraud." *First Jersey*, 101 F. 3d at 1476.

b. Grossman's Arguments on Disgorgement Should be Rejected

52. Aside from arguing the Division's disgorgement claim is barred by the five-year statute of limitations set forth in 28 U.S.C. § 2462 (which, for the reasons set forth in Section III.D above, it is not), Grossman also argues in his Prehearing Brief the Division's disgorgement

[34] Should the Law Judge determine to award prejudgment interest, the Division can provide a calculation of the amount from November 21, 2008 to the date judgment is entered.

claim is barred because there is no causal connection between the amounts to be disgorged (the fees and compensation paid under the Referral and Consulting Agreements) and the allegations the Division raised in the OIP, and further because the Division did not call as witnesses every single Sovereign client who invested in the Battoo Funds and PIWM and from whom Grossman generated fees and compensation under the Referral and Consulting Agreements. At the hearing, Grossman also argued that any disgorgement award against him would have to be reduced by (i) the amount of any judgments or settlements that he paid in private litigation; and (ii) the amount of tax liability be paid to the IRS for the fees and compensation he earned under the Referral and Consulting Agreements. The Law Judge should reject all of these arguments.

53. First, with respect to the "causal connection" argument, contrary to Grossman's position, the Division alleged quite clearly in the OIP, and introduced supporting evidence at the hearing, that Grossman failed to properly disclose to Sovereign clients the fees and compensation he was earning. (*See* OIP ¶¶ 27-32; PFF at 36-50.) Grossman cites *SEC v. Seghers*, 404 Fed. Appx. 863 (5th Cir. 2010) in support of his argument. There, the court denied a claim for disgorgement because the Commission did not properly distinguish between amounts in the subject account that were legally obtained from those that were obtained as a result of the fraud. *Id.* at 864. Here, however, the Division's forensic accountant, Kathleen Strandell, testified at the hearing that she included in her disgorgement calculation only those amounts that were paid to the Jyske Bank account under the Referral and Consulting Agreements. (PFF at 35.) And Grossman himself testified at the hearing that the Jyske Bank account was used for no purpose other than receiving the fees and compensation under the Referral and Consulting Agreements *(i.e.*, the amounts constituting the fraud in this proceeding). (*Id.* at 34.) As noted, Grossman had the opportunity to cross-examine Strandell at the hearing, but elected not to (*Id.* at 35 n. 11.)

54. Second, contrary to Grossman's argument, it was not necessary for the Division to call as witnesses every single Sovereign client who invested in the Battoo Funds and PIWM. In his Prehearing Brief, Grossman cites *Blatt*, 583 F.2d 1325, *Manor Nursing Centers*, 458 F.2d 1082, and *In the Matter of Joseph J. Barbato*, AP File No. 3-8575, 1999 SEC LEXIS 276 (Feb. 10, 1999), in support of his position. None of those cases, however, supports Grossman's argument. *Blatt* made no mention of the necessity of calling all investor clients to testify, but held that a disgorgement award is remedial and a defendant can be compelled to disgorge only those profits that were wrongfully obtained. *Blatt*, 583 F.2d at 1335. As noted above, the Division's undisputed disgorgement evidence, as presented by Strandell, is limited only to the fees and compensation paid to the Jyske Bank account under the Referral and Consulting Agreements. These fees were wrongfully and fraudulently obtained and were not properly disclosed to Sovereign clients. As a result, under *Blatt*, Grossman can be compelled to disgorge the full $3,407,765.66. Similarly, the Second Circuit in *Manor Nursing Centers* made no mention of the number of investors needed during trial, and held that "[t]he deterrent effect of an SEC enforcement action would be greatly undermined if securities laws violators were not required to disgorge illicit profits." *Manor Nursing Centers*, 458 F.2d at 1104. The Second Circuit drew a distinction only between the proceeds of the fraud and income earned on the proceeds. *Id.* Here, however, we are concerned only with the proceeds of the fraud, which Strandell testified amount to a total of $3,407,765.66. Finally, while *Barbato* limited the Division's disgorgement claim only to those investors who testified at the hearing, *Barbato* is easily distinguishable.[35] There, the evidence was client-specific – whether the respondent churned a particular client's account and whether the respondent even traded in a particular client's account. *Barbato*, 1999 SEC LEXIS at *44.

[35] Notably, *Barbato* also rejected the respondent's argument that the Division's disgorgement claim was barred by the statute of limitations under 28 U.S.C. § 2462. *Barbato*, 1999 SEC LEXIS at *43.

55. Here, on the other hand, the fraud at issue was not client-specific, but applied to all Sovereign clients equally. Indeed, the fees and compensation under the Referral and Consulting Agreements were not disclosed in Sovereign's Form ADVs Parts 1 and II, Sovereign's IAA, and in the private placement memoranda and subscription agreements for the Anchor Hedge Fund and FuturesOne. (PFF at 36-50.) These same documents would have been provided to all Sovereign clients.

56. With respect to Grossman's set-off argument, as a preliminary matter, even if he were correct that a disgorgement award should be offset by amounts paid in private litigation and by amounts paid to the IRS (which, as noted below, is not the case), Grossman failed to plead set-off, offset or any comparable position as an affirmative defense under Rule 220(c) of the Commission's Rules of Practice. Accordingly, he waived the right to argue for such a reduction, and the same must be rejected outright. *See In The Matter of Philip A. Lehman*, AP File No. 3-11972, 2006 SEC LEXIS 659, at *13 (Mar. 20, 2006); *In The Matter of George J. Kolar*, AP File No. 3-9570, 1999 SEC LEXIS 2300, at *71 (Oct. 28, 1999).

57. Even assuming, however, that Grossman properly pled reduction as an affirmative defense, it is well settled that income taxes a defendant pays on his ill-gotten gains cannot be used to offset a disgorgement award in an enforcement action. *SEC v. U.S. Pension Trust Corp.*, 444 Fed. Appx. 435, 437 (11th Cir. 2011); *SEC v. Razmilovic*, 822 F. Supp. 2d 234, 277 (E.D.N.Y. 2011), *rev'd on other grounds*, 738 F.3d 14 (2d Cir. 2013); *SEC v. Koenig*, 532 F. Supp. 2d 987, 994 (N.D. Ill. 2007).

58. In addition, where, as here, the judgments or settlements imposed in private party litigation do not concern the same securities violations for which the Commission seeks disgorgement in an enforcement action, it is improper to set off the amount of the private judgment or settlement from a disgorgement award. *SEC v. Johnston*, Case No. 93-cv-73541, 1994 U.S. Dist.

LEXIS 14100, at *12 (E.D. Mich. Aug. 2, 1994), *rev'd on other grounds*, 143 F.3d 260 (6th Cir. 1998); *SEC v. Shah*, Case No. 92-cv-1952, 1993 U.S. Dist. LEXIS 10347, at *11-12 (S.D.N.Y. July 28, 1993); *SEC v. Solow*, 554 F. Supp. 2d 1356, 1364 (S.D. Fla. 2008). The Division notes that Grossman introduced no evidence at the hearing, or as part of his proffer, that the same violations at issue in the private party proceedings are at issue in the present enforcement action. In reality, however, as is usually the case with respect to this issue, the disgorgement award the Division seeks in this enforcement action is based on the amount of Grossman's undisclosed pecuniary gain (the fees and compensation he received under the Referral and Consulting Agreements), while private party litigation seeks the return of a client's investment principal or seeks to charge the investment adviser with the full amount of the client's loss.

59. Accordingly, the Law Judge should dismiss Grossman's "causal connection" and set-off arguments as a matter of law.

(b) Civil Penalty

60. 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); *K.W. Brown*, 555 F. Supp. 2d at 1314; *SEC v. Tanner,* Case No. 02-0306, 2003 WL 21523978 at *2 (S.D.N.Y. July 3, 2003); *Kenton Capital*, 69 F. Supp. 2d at 17; *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.

61. 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.

62. Under the first tier, the Law Judge 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 Law Judge 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 Law Judge 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 clients were invested in the Battoo Funds and PIWM and sustained significant losses of their investments, the Law Judge should impose a third-tier civil penalty on Grossman. (PFF at 72.)[36]

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

63. 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 for ***each*** violation that occurred in this case.

64. 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 merits a high penalty. As discussed above, his conduct was egregious and recurrent, and he 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 Grossman for his unlawful activities and deter others from engaging in violations of the federal securities laws. Indeed, a monetary penalty also would deter Grossman 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.*, AP File No. 3-9657, 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 efforts to conceal his compensation from Sovereign clients, and his disregard of obvious warning signs that should never have led him to recommend the Battoo Funds and PIWM in the first place, the Division submits a third-tier penalty in the amount of Grossman's pecuniary gain ($3,407,765.66) is an appropriate

penalty to impose in this proceeding. Law Judges and District Courts have routinely imposed pecuniary gain penalties on investment advisers where, as here, the adviser has engaged in significant misconduct. *See, e.g., In the Matter of Richard P. Sandru*, AP File No. 3-15268, 2013 SEC LEXIS 2346, at *26 (Aug. 12, 2013); *SEC v. Souza*, No. 09-cv-2421, 2011 U.S. Dist. LEXIS 59626, at *7-8 (E.D. Cal. June 3, 2011); *SEC v. Locke Capital Mgmt.*, 794 F. Supp. 2d 355, 371 (D.R.I. 2011); *SEC v. Alvieri*, No. 02-cv-7893, slip op., at 5 (S.D.N.Y. Mar. 28, 2008); *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007).

65. A third-tier penalty is further warranted in this case because, as detailed in this brief, Grossman's misconduct involved fraud and deceit, and further because the misconduct caused substantial losses or created a significant risk of substantial losses on the part of Sovereign clients. (PFF at 72.)

B. A Cease-and-Desist Order Is Appropriate

66. 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.

67. 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. *In the Matter of KPMG Peat Marwick, LLP*, AP File No. 3-9500, 2001 WL 47245, at *23-26 n. 115 (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*, AP File No. 3-3758, 1975 WL 160534 at *2 (Dec. 16, 1975).

68. Here, all the factors weigh in favor of the Law Judge imposing cease-and-desist orders on Grossman. His actions were highly egregious. His misrepresentations, omissions and deceptive conduct ensured that Sovereign clients would be kept in the dark concerning the fees and compensation Grossman received from Battoo, and prevented clients from evaluating the conflict of interest in choosing to invest in the Battoo Funds and PIWM. Furthermore, Grossman 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 engaged in this misconduct for the most selfish of reasons – his own financial interest. As a result of his misconduct, Sovereign clients lost the entirety of their investments. It is hard to imagine any more egregious circumstances.

69. Grossman's actions also were recurrent. He 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 continued to profit at the expense of his clients. Moreover, he continually failed to provide the correct disclosure of his compensation in Sovereign's IAAs and Form ADVs distributed to clients.

70. As discussed above, Grossman also displayed a high degree of scienter since he knew flat out he was hiding the full truth about his compensation from clients and about the fact that the Battoo Funds and PIWM were not the investments that the PPMs and other promotional materials portrayed them to be.

71. As to the fourth and fifth factors, Grossman has not acknowledged the wrongfulness of his conduct; consequently he has not given and cannot give any assurances against future misconduct. Finally, Grossman remains employed in the industry and will have the opportunity to re-offend. This is particularly true given his overlapping work for Sovereign and SIPS even after he sold Sovereign to Adams.

72. For all those reasons, the Law Judge should enter a cease-and-desist order against him.

C. Industry Bars Are Appropriate

73. The same six *Steadman* factors apply to the consideration of a broker-dealer and related industry bars against Grossman. Here, applying the *Steadman* factors as we did in the immediately preceding section weighs heavily in favor of permanently barring Grossman from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; and prohibiting him 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.

74. The Commission has held conduct like that of Grossman, 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*, AP File No. 3-11536, 2007 WL 98919 at *5 (Jan. 16, 2007).

75. Here, the Division requests the Law Judge collaterally bar Grossman from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; and prohibit him 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).

76. 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. *See In the Matter of John W. Lawton*, Advisers Act Release No. 3513, 2012 WL 6208750 (Dec. 13, 2012); *In the Matter of Korem*, AP File No. 3-14208, Advisers Act Release No. 70044, 2013 WL 3864511 (July 26, 2013).

77. 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").

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

V. CONCLUSION

79. For the foregoing reasons, the Law Judge should find Grossman violated Section 17(a) of the Securities Act; Section 15(a) of the Exchange Act; and Sections 206(1), 206(2), 206(3) and 207 of the Advisers Act; and willfully aided and abetted and caused violations of Section 15(a) of the Exchange Act, 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 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

Sunny H. Kim
Senior Counsel
Direct Line: (305) 416-6250
Email: kimsu@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