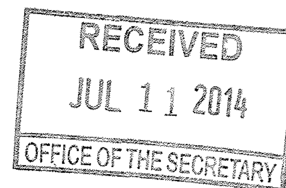
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15617

In the Matter of

LARRY C. GROSSMAN
and GREGORY J. ADAMS,

Respondents.

DIVISION OF ENFORCEMENT'S POSTHEARING REPLY BRIEF

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I. INTRODUCTION

The Division files this Reply Brief to address the proposed findings of fact and legal arguments made by Respondent Larry C. Grossman in his Response Brief. As set forth in more detail below, Grossman omits important details from his proposed findings of fact, and his legal arguments are invalid as a matter of law and should be rejected.

For the reasons set forth herein, and in the Division's Initial Posthearing Brief filed on May 23, 2014, 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 charges, and we ask the Law Judge to enter a cease-and-desist order; industry bar; disgorgement in the amount of $3,407,765.66 plus prejudgment interest; and a third-tier civil penalty in the amount of $3,407,765.66.

II. RESPONSE TO GROSSMAN'S PROPOSED FINDINGS OF FACT

The Division responds as follows to Grossman's Proposed Findings of Fact ("GPFF") in order to clarify some of Grossman's statements:

With respect to GPFF 2, the Division notes the parties do not dispute that Sovereign clients were provided with a form authorizing a wire transfer to AH Florida's account at EverBank. Indeed, the Division submitted a similar proposed finding of fact. (*See* Initial Brief, Division's Proposed Finding of Fact 15 ("DPFF")). The issue in this proceeding is whether Grossman disclosed (i) that all client investments in the Battoo Funds and PIWM would be pooled together in AH Florida's bank account; and (ii) his ownership interest in AH Florida. As the Division noted in DPFF 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, however, 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.) The Division also noted in DPFF 17 that 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, 69:4-9, 121:15-22; DX 50 at ¶ 23.) Grossman never disclosed his ownership of AH Florida to clients. (*See id.*)

With respect to GPFF 3, the Division notes the only written evidence Grossman presented as to the investment strategy and style he allegedly provided to Sovereign clients is Grossman's Exhibit 99, which is a proposal to client Stephen Richards. However, during his testimony deposition, when presented with a copy of the same document, Richards stated "I've never seen these documents before." (DX 152 at 169:21-22.) In fact, Richards even questioned whether the documents were "manufactured" after the fact. (*Id.* at 170:11-12.)

With respect to GPFF 4, the Division notes that contrary to Grossman's statement that he did not solicit potential clients, the Division introduced uncontroverted evidence that Grossman in fact did so. (*See* DX 50 at ¶ 3.) In addition, during his ownership of Sovereign, the company maintained a website that prospective and current clients could access to learn more about Sovereign's services. (Tr. Vol. I at 197:1-15.)

With respect to GPFF 5, the Division introduced evidence at the final hearing that while Sovereign clients communicated their investment goals of preservation of base retirement funds,

capital growth and low to medium risk portfolios, Grossman nevertheless advised Sovereign clients to invest almost exclusively in the Battoo Funds and PIWM, regardless of the clients' investment objectives. (Tr. Vol. I at 33:2-3; Tr. Vol. II at 354:4-11; 453:19-23; DX 50 at ¶¶ 4, 6, 16; DX 152 at 22:10-16, 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.) In addition, Grossman notes in GPFF 5 that he had verbal discussions with clients concerning the fees charged to them. The issue for this proceeding, however, is not the fees ***Sovereign*** charged the clients, but the fees and compensation that Battoo paid Grossman under the Referral and Consulting Agreements. The Division introduced uncontroverted evidence at the final hearing that Grossman never disclosed those fees to Sovereign clients, including to C.W. Gilluly, who was one of Grossman's own witnesses. (Tr. Vol. I at 39:13-17, 41:9-13, 62:1-25, 111:22-25, 112:1-4, 123:19-25, 124:1-18; Vol. II at 554:4-23; DX 152 at 75:1-25, 76:1-13; DX 50 at ¶ 7.)

With respect to GPFF 9 and 21, the Division notes that according to the terms of the International Consultant Agreement (DX 74), Grossman contracted to do much more than, as he claims, simply provide advice on whether IRAs or qualified plans could invest the Anchor Hedge Fund's investment platforms. Instead, Grossman also agreed to continuously analyze the performance of all investments in the Anchor Hedge Fund; provide recommendations on redemptions of shares in the fund; advise on how the fund should carry out its investment objectives; prepare materials for the monthly and other periodic reports the fund would publish; and prepare reports for the directors of the fund. (DX 74 at 3.) During the hearing, Grossman attempted to distance himself from the impact of these duties by claiming that he requested from the management of the Anchor Hedge Fund letters confirming that despite his duties under the agreement to the contrary, he did not actually provide any

investment advice to the fund. (Tr. Vol. I at 252:17-25.) Those letters, however, were not provided until July 1, 2008 – almost ***five years*** after Grossman signed the International Consultant Agreement and Sovereign had begun operations, and – coincidentally – a ***few months*** after the Commission's Office of Compliance, Inspections and Examinations ("OCIE") began its second examination of Sovereign in May 2008. (*See* GX 13 and GX 14.)

With respect to GPFF 15, as noted above, Richards disputes ever receiving GX 99 (the investment proposal Grossman claims he sent). (DX 152 at 169:21-22; 170:9-12.) Moreover, Richards also disputes sending an email to Grossman commenting on the presentation. In fact, during his testimony deposition, Richards disputed the email address listed for him on the email and testified that he did not use that email address, and therefore, could not have authored the email. (DX 152 at 224:23-25; 225:1-17.)

With respect to GPFF 17, the Division notes that even if Sovereign clients received the Form ADV Part II – and, as set forth at the hearing, they did not (*see* Tr. Vol. I at 43:12-16; DX 152 at 83:18-23) – use of the word "may receive" in the disclosures was still misleading as a matter of law because Sovereign and Grossman in fact ***actually were receiving*** fees from Battoo. *See* Section III.B.1 below.

With respect to GPFF 18, 19 and 21, the Division notes that Grossman is listed in the private placement memoranda for Anchor Hedge Fund Classes A and C as a member of the investment advisory board, not as an investment adviser. (DX 25 at 5; DX 28 at 5.) The Division also notes the private placement memoranda indicate the investment adviser of the fund may be paid a fee by the investment manager, but there is no mention anywhere in the documents that members of the investment advisory board also may be paid a fee. (*See* DX 25 and DX 28.) And at the final hearing, Grossman denied giving investment advice to the Anchor Hedge Fund (*see* Tr. Vol. I at 252:17-20; *see also* GX 14) and thus, in his own words, could not have been acting as an investment adviser.

With respect to GPFF 22, the information Battoo provided Grossman also included the identity of the Anchor Hedge Fund's underlying funds. (Tr. Vol. I at 286:5-13.) 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.[1] (*Id.* at 323:25; 324:2-4.) And yet, up until 2008 when he sold Sovereign, Grossman claimed 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.)

With respect to GPFF 23, at the hearing the Law Judge questioned the validity of relying on the information in the various hedge fund databases that Grossman claimed to have reviewed as part of his alleged due diligence, because those databases received their information directly from the funds. (Tr. Vol. II at 343:4-7.) The Law Judge remarked that such "self-reporting" data could not be of much validity. (*Id.* at 343:8-9, 12.)

With respect to GPFF 24, 26 and 27, as the Division discusses at length below in Section III.A.3, Grossman remained involved in Sovereign's operations and in giving investment advice to Sovereign clients following the sale of the company to Adams.

With respect to GPFF 25, the Division notes the email Grossman authored also informed Sovereign clients that Grossman would remain on Sovereign's Board of Advisors. (DX 64 at 2.)

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[1] 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.)

With respect to GPFF 29, 30 and 31, despite Grossman's claim to the contrary, the Division introduced evidence at the hearing showing Grossman in fact was involved in the share exchange between Anchor Hedge Fund Class C and PIWM. (Tr. Vol. I at 145:25, 146:1-6; *see also* DX 113 and DX 113-1.) 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.) In addition, Carmen Montes testified she received Grossman's letter to her on November 21, 2008, recommending that she exchange her shares between Anchor Hedge Fund Class C and PIWM. (Tr. Vol. I at 145:25, 146:1-6; *see also* DX 113-1.) And with respect to Jessina Paturzo, as the Division discusses in Footnote 9 below, her testimony is simply not credible.

III. LEGAL DISCUSSION

A. The Division's Claims Are Not Barred By The Statute Of Limitations Set Forth In 28 U.S.C. § 2462.

In his Response Brief, Grossman contends all of the remedies the Division seeks in this proceeding, both legal and equitable, are barred by the five-year statute of limitations set forth in 28 U.S.C. § 2462. Grossman wrongly interprets the Supreme Court's recent decision in *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) as uprooting decades of prior decisions by both Law Judges of the Commission and district courts that have held equitable claims, including disgorgement, cease-and-desist orders and industry bars, are not subject to 28 U.S.C. § 2462. Instead, Grossman cites a single decision by the Southern District of Florida, *SEC v. Graham*, No. 13-cv-10011, 2014 U.S. Dist. LEXIS 64953 (S.D. Fla. May 12, 2014),[2] that itself misinterpreted *Gabelli* and found equitable claims

[2] *Graham* has no precedential value here, as it is a decision by the Southern District of Florida, not the Middle District of Florida where this proceeding was based.

to be subject to the five-year limitations period in 28 U.S.C. § 2462. Conveniently, Grossman ignores the wealth of other cases and decisions since *Gabelli* that have held the complete opposite.

1. *Gabelli*, By Its Own Terms, Is Limited To Civil Penalties.

As Grossman himself acknowledges in his Response Brief, the Supreme Court in *Gabelli* "specifically held that it was not addressing the issue" as to whether the five-year limitations period in 28 U.S.C. § 2462 applied to the Division's equitable claims. (Response Brief, at 13.) Indeed, the Supreme Court noted:

> The SEC also sought injunctive relief and disgorgement, claims the District Court found timely on the ground that they were not subject to § 2462. Those issues are not before us.

Gabelli, 133 S. Ct. at 1220. Instead, the Supreme Court decided the limited issue of whether the discovery rule tolled the running of the statute of limitations under 28 U.S.C. § 2462 for the Commission's claim for a civil penalty. *Id.* at 1219.[3]

In the wake of *Gabelli*, Law Judges and district court judges consistently have held the Supreme Court's opinion is limited just to civil penalties, and has absolutely no bearing on equitable claims. *See, e.g.*, *In the Matter of Gregory Bartko*, AP File No. 3-14700, 2014 SEC LEXIS 841, at *33-34 (Mar. 7, 2014) (noting that an industry bar does not constitute a "civil fine, penalty, or forfeiture, pecuniary or otherwise" because such bars are "not based on a need to 'punish the respondent for past misconduct'" but to protect investors by restricting the respondent's access to other areas of the industry to prevent future harm); *In the Matter of Joseph P. Doxey*, AP File No. 3-15619, 2014 SEC LEXIS 1668, at *65 (May 15, 2014) ("Disgorgement does not serve a punitive function, but is designed to force wrongdoers to return the fruits of illegal conduct"); *In the Matter of Barclays Bank PLC*, Docket No. IN08-8-000, 2013 WL 3962269, at *40 n. 365 (July 16, 2013) ("[T]he Supreme Court recently held that the SEC's civil penalty provisions are subject to the general

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[3] Despite Grossman's contention otherwise, *Gabelli* does not hold, let alone even mention, the Division is held to a higher standard than private litigants for statute of limitations purposes. (Response Brief, at 13.)

federal statute of limitations, leaving intact the lower court holding that disgorgement is not so limited"); *SEC v. Geswein*, Case No. 10-cv-1235, 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); *SEC v. Amerindo Investment Advisors, Inc.*, Case No. 05-cv-5231, 2014 U.S. Dist. LEXIS 15696, at *26 (S.D.N.Y. Feb. 3, 2014) ("[T]he statute of limitations at issue in *Gabelli* applies only to civil penalties, and does not prevent a finding of liability or an awarding of other kinds of remedies"); *CFTC v. Reisinger*, Case No. 11-cv-8567, 2013 U.S. Dist. LEXIS 100960, at *22 (N.D. Ill. July 18, 2013) ("Section 2462, however, applies only to suits seeking civil penalties").

In his Response Brief, Grossman relies at length on a single, isolated case in the Southern District of Florida that goes against the multitude of decisions by Law Judges and other courts cited above holding that *Gabelli* is limited just to claims for civil penalties. In *Graham*, the district court held that it lacked subject matter jurisdiction over the Commission's claims, both legal and equitable, because all claims were time-barred under 28 U.S.C. § 2462. *Graham*, 2014 U.S. Dist LEXIS 64953, at *3-4. The court ruled none of the Commission's claims fell within the "red zone," which the court defined as the five-year period prior to the filing of the Commission's complaint. *Id.* at *23-24. The court believed the claims all accrued before the "red zone" period began. *Id.*

The Division submits that *Graham* is of no precedential value in this proceeding, and the Law Judge therefore should disregard it. First, the district court itself acknowledged it was charting unexplored territory in reaching its decision, noting the Supreme Court in *Gabelli* "***expressly declined*** to reach the question whether injunctive relief and disgorgement are also covered by § 2462, ***as the question was not properly before it***." *Id.* at *25-26 (emphasis added). Rather than follow *Gabelli's* mandate as Law Judges and other district courts have done, *Graham* chose to ignore the decision and

unnecessarily expand a rule of law that goes against the decades of precedent the Division cites in Section III.A.2 below that clearly holds equitable claims are not subject to the limitations period.

Second, given the multitude of decisions by Law Judges and other courts cited above holding that *Gabelli* is limited just to claims for civil penalties, it is debatable how valid the decision in *Graham* actually is. Indeed, the Commission is currently considering its options in response to *Graham*, including whether to take an appeal to the Eleventh Circuit.

And third, again assuming *Graham* were of any precedential value, as noted in Section III.A.3 below, in this proceeding, unlike *Graham*, the Division introduced substantial evidence at the final hearing of Grossman's misconduct that took place within the "red zone." Accordingly, the Division's claims based on that misconduct are timely, and because the continuing violations exception to the statute of limitations applies to this case (*see* Section III.A.3 below), all of Grossman's misconduct that predates the "red zone" also would be considered timely for purposes of assessing a civil penalty against him.

In short, simply because the Supreme Court in *Gabelli* elected on its own accord not to decide the issue of whether the five-year limitations period in 28 U.S.C. § 2462 applies to equitable claims does not mean, as Grossman would have us believe, that "the door was left wide open" on this issue. (Response Brief, at 13.) Indeed, considering the door was never open in the first place (as evidenced by the wealth of case law the Division cites below in Section III.A.2 that holds equitable claims are not subject to the limitations period), the Supreme Court's decision not to address the subject is just that – a decision not to address the subject. It means nothing more and nothing less.

2. Prior Decisions By Law Judges Of The Commission And By District Courts Have Universally Held Equitable Claims Are Not Subject To 28 U.S.C. § 2462.

As noted in Section III.A.1 above, *Gabelli* did not change the longstanding precedent that Law Judges and district courts have consistently followed in Commission enforcement proceedings that

holds equitable claims, including disgorgement, cease-and-desist orders and industry bars, are not subject to 28 U.S.C. § 2462.[4] *See, e.g.*, *In the Matter of Prime Capital Services, Inc.*, AP File No. 3-13532, 2010 SEC LEXIS 2086, at *9 (June 25, 2010) (disgorgement and cease-and-desist orders are not subject to 28 U.S.C. § 2462); *In re John A. 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*, 950 F. Supp. 2d 547 (S.D.N.Y. 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)..

Both of the cases Grossman cites in his Response Brief on this subject are distinguishable. In *SEC v. Microtune, Inc.*, 783 F. Supp. 2d 867 (N.D. Tex. 2011), the district court held that equitable

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[4] In his Response Brief, Grossman cites, but clearly misconstrues, the Second Circuit's decision in *SEC v. Contorinis*, 743 F.3d 296 (2d Cir. 2014) for the proposition that disgorgement is akin to a forfeiture and thus constitutes a penalty. (Response Brief, at 14 n. 5.) The Second Circuit did not make that comparison. Instead, the court went into an at-length discussion of the myriad ways in which disgorgement expressly differs from forfeiture. *See id.* at 306-307. In concluding the two remedies are fundamentally different, the court held that "disgorgement [unlike a forfeiture] is imposed not to punish, but to ensure illegal actions do not yield unwarranted enrichment even to innocent parties." *Id.* at 307.

claims for injunctive relief and officer-and-director bars[5] 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. Similarly, in *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996), the court found a censure and suspension of a securities license based on a failure-to-supervise charge to be a penalty, and therefore subject to 28 U.S.C. § 2462, because there was no evidence presented as to the risk the defendant posed to the public or any finding of incompetence directly related to her role as a supervisor. *Id.* at 489.

The facts in this proceeding, however, are readily distinguishable from *Microtune* and *Johnson*. First, by his own admission, Grossman no longer renders investment advice through his company, SIPS, and acts solely as an IRA administrator. Accordingly, he would suffer no collateral consequences as a result of the Division's requested cease-and-desist order and industry bar. Second, and as a result of the first, the 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. *See Bartko*, 2014 SEC LEXIS 841, at *33-34 (noting that an industry bar does not constitute a "civil fine, penalty, or forfeiture, pecuniary or otherwise" because such bars are designed to protect investors by restricting the respondent's access to other areas of the industry to prevent future harm). And third, despite Grossman's argument to the contrary, the Division's evidence showed Grossman continued to act as an investment adviser, even after he sold Sovereign to Adams, and continued to engage in misconduct by promoting the Battoo Funds and PIWM to Sovereign clients. Accordingly, 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.

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

As demonstrated, the Division's cited precedent remains well-established, and the Law Judge should validate the same in finding the Division's equitable claims for disgorgement, a cease-and-desist order and industry bar against Grossman to be timely.

3. Even If 28 U.S.C. § 2462 Were Applicable To This Proceeding, The Division's Claim For a Civil Penalty Is Not Time Barred.

As noted above, the Division's equitable claims for disgorgement, a cease-and-desist order and industry bar against Grossman are not subject to the five-year limitations period set forth in 28 U.S.C. § 2462. To the extent the statute applies in this proceeding, it would impact only the Division's claim for a civil penalty. Despite Grossman's argument to the contrary, however, the civil penalty claim is not time barred.

(a) Grossman Engaged In Misconduct That Falls Within The Five-Year Limitations Period.

The Division introduced substantial evidence at the final hearing demonstrating Grossman engaged in misconduct that falls within the five-year limitations period, or "red zone" as defined in *Graham*. The Division filed the OIP on November 20, 2013. That would make the applicable red zone period November 20, 2008 through November 20, 2013.

In his Response Brief, Grossman contends all of the Division's claims accrued prior to the beginning of the red zone period. (Response Brief, at 14-20.) Specifically, Grossman contends the Division's claims, at least those causes of action based on Grossman's failure to disclose the fees and compensation he received under the Referral and Consulting Agreements, accrued at the time OCIE issued its deficiency letter on February 7, 2005. (Response Brief, at 16.) Grossman further contends the Division's claims that are based on failure to disclose the risks to Sovereign clients concerning

investments in the Battoo Funds and PIWM accrued at the time Grossman received the private placement memoranda and financial statements from Battoo. (Response Brief, at 17-18.)[6]

Grossman misconstrues the concept of accrual. First, the Division's claims could not have accrued at the time of the examination. As the Law Judge correctly observed during the final hearing:

> An examination is a completely different thing from an OIP with allegations. An examination – it's just two completely different things.

(Tr. Vol. III. 713:15-18). Indeed, the deficiency letter issued on February 7, 2005 states very clearly that "[t]he above findings are based on the staff's examination ***and are not findings or conclusions of the Commission***." (DX 141 at 5.) (emphasis added). And the Law Judge confirmed at the Prehearing Conference held on March 7, 2014 that whether an examination took place "doesn't have anything to do with whether the allegations in the OIP are accurate." (Prehearing Conference Transcript, at 50:19-21.) Instead, the operative period here is the five-year red zone between November 20, 2008 through November 20, 2013. If Grossman's misconduct occurred within that period, it is sanctionable in civil penalties. Second, while the Division concedes that some of Grossman's misconduct predates the red zone period, such misconduct would be brought into the red zone by virtue of the continuing violations exception to the statute of limitations. *See* Section III.A.3(b) below.[7] And third, Grossman cannot escape liability for his misconduct by claiming that his failure to fully investigate the Battoo Funds and PIWM occurred, and concluded, at the exact moment he received the materials from Battoo. Instead, every single time he recommended an investment to clients in these funds, spanning

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[6] Additionally, Grossman contends the Division concedes in its Initial Brief that its claim for a civil penalty based on violations of Section 15(b) of the Exchange Act and Section 206(4), Section 207 and Rule 206(4)-2 of the Advisers Act, accrued only before November 20, 2008. (Response Brief, at 20.) The Division makes no such concession. Instead, as noted in Section III.A.3 above, Grossman engaged in independent misconduct that took place within the red zone. Moreover, even if the Division's claims had first accrued prior to the beginning of the red zone period, the continuing violations exception to the statute of limitations would support a civil penalty against Grossman based on that pre-red zone misconduct.

[7] Even if the continuing violations exception is found not to apply in this proceeding, however, Grossman's pre-red zone misconduct would still be relevant for purposes of assessing civil penalties. As the Law Judge correctly acknowledged at the prehearing conference, she can "consider violations beyond the five-year period in assessing sanctions." (Prehearing Conference Transcript, at 49:15-17.) *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).

the period from 2003 until 2009, he wilfully violated the securities laws. *See, e.g.*, *In the Matter of Raymond J. Lucia Cos., Inc.*, AP File No. 3-15006, 2013 SEC LEXIS 3856, at *156-157 (Dec. 6, 2013) (noting that each distribution of the misleading investor presentation was a separate and distinct violation); *Doxey*, 2014 SEC LEXIS 1668, at *56 (each misrepresentation of the company's operations to the investing public was a separate and distinct violation).

Regardless of the time of accrual, Grossman still engaged in misconduct that independently falls inside the five-year limitations period. Such misconduct constitutes separate and distinct violations of the securities laws that all accrued well within the red zone. *See Raymond J. Lucia*, 2013 SEC LEXIS 3856, at *156-157; *Doxey*, 2014 SEC LEXIS 1668, at *56. For example, Grossman represented to Sovereign clients that following the sale of the company to Adams, he remained on the Board of Advisors for the company. (DX 64 at 2.) In addition, Sovereign clients testified at the final hearing that Grossman worked closely with them on their investments through January 2009 and continued to serve as, and represented that he remained, their investment advisor[8] (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 also testified Grossman sent them signed letters on November 21, 2008 making specific misrepresentations to invest in the Battoo Funds and PIWM (Tr. Vol. I at 145:14-20, 25; 146:1-6; DX 113 at 2; DX 113-1 at 2)[9], and advised them on the status of their Anchor Hedge

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[8] 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.)

[9] These letters alone would be sufficient for purposes of assessing a civil penalty and for invocation of the continuing violations doctrine because, as Sovereign clients testified repeatedly at the final hearing, Grossman never disclosed the fees and compensation he received under the Referral and Consulting Agreements for recommending Sovereign clients invest in the Battoo Funds and PIWM. This failure to disclose the fees and compensation took place both inside and prior to the red zone. Grossman attempted to sidestep the significance of the letters (DX 113 and 113-1) by proffering the testimony of Jessina Paturzo at the final hearing. Paturzo testified she allegedly made an error and sent out the letters herself, which were the incorrect forms. (Tr. Vol. II at 574:20-25; 575:20-25; 576:1-6.) Given that Paturzo currently works for Grossman (and is thus biased in his favor, as he ultimately controls her continued employment status), and given further her concession on cross examination that she actually was intimately familiar with the correct forms Sovereign used, her testimony on this matter is not credible. Furthermore, contrary to Grossman's interpretation in the Response Brief of Adams' testimony, Adams actually testified he recognized the letters as forms used for the investment recommendations, and could not say for sure that Grossman did not send the letters to

Fund investments 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 and receiving a paycheck as late as March 23, 2009 (Tr. Vol. II at 454:6-17; DX 48 at 3). 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 (Tr. Vol. II at 472:16-19).

Additionally, 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). He also continued to assist Adams as an investment advisor as late as February 19, 2010 (DX 123 at 1) and even planned, as late as December of 2010, to meet with Adams on a weekly basis to discuss Sovereign's operations (DX 119 at 1).

Each of these actions 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.) In addition, 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.)

Sovereign clients himself. (Tr. Vol. II at 502:23-25; 503:1-4; 507:18-20.) The Division's witness, Carmen Montes, provided uncontroverted testimony that she in fact received the letter from Grossman. (Tr. Vol. I at 146:1-6.)

As all of this evidence demonstrates, Grossman engaged in separate and distinct conduct that falls within the red zone. The Division's claim for a civil penalty based on that conduct therefore is timely.

(b) Under The Continuing Violations Doctrine, All Of Grossman's Misconduct That Predates The "Red Zone" Period Is Considered Timely For Purposes Of Assessing A Civil Penalty Under 28 U.S.C. § 2462.

The Commission filed the OIP on November 20, 2013. As the Division's evidence demonstrated, however, Grossman's misconduct continued beyond five years before that, or November 20, 2008, and thus falls outside the red zone. However, any such earlier misconduct 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 limitations period 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).

As set forth above in Section III.A.3, the Division introduced evidence at the final hearing of Grossman's misconduct that took place within the red zone, including his misrepresentations to investors to purchase the Battoo Funds and PIWM. In that regard, he continued to perpetrate his fraudulent activities into the limitations period, and even remained on the Sovereign payroll more than four months after the five-year period began.

In his Response Brief, Grossman attempts to downplay the significance of his activities in the red zone, even going to so far as to misinterpret his own witness' testimony. Indeed, Grossman cites

the transcript of Adams' testimony for the proposition that following the sale of Sovereign on October 1, 2008, Grossman did not have (i) any decision-making authority; (ii) the ability to sign checks on the company's behalf; or (iii) the ability to enter into contracts for the company. (Response Brief, at 22.) Adams, however, did not make any of those statements during his testimony, nor was he ever asked those questions by Grossman's counsel. Instead, he testified only that Grossman did not have the authority to sign Sovereign's Form ADVs Part 1 following the sale of the company on October 1, 2008. (Tr. Vol. II 495:13-22.) Interestingly, however, Adams admitted at the final hearing that Grossman in fact signed the Form ADV dated December 23, 2008. (*Id.* at 464:4-11.)

Moreover, Grossman has not disputed any of the evidence the Division introduced at the final hearing showing his misconduct that occurred during the red zone and its interrelationship with the misconduct that occurred prior to the beginning of the red zone period. Realizing this deficiency, Grossman attempts to find his way out of this tight spot by relying on *SEC v. Leslie*, Case No. 07-cv-3444, 2010 U.S. Dist. LEXIS 76826 (N.D. Cal. July 29, 2010). There, the district court found the continuing violations doctrine not to apply because the Commission was unable to show any misconduct on the part of the defendant that occurred inside the red zone. *See id.* at 105. Instead, the Commission could only point to the continuing ill effects of the original violations, all of which occurred prior to the beginning of the red zone period. *See id.* Here, however, we do not have a situation where only the ill effects are present during the red zone. Instead, as noted at length in Section III.A.3 above, Grossman engaged in specific misconduct and unlawful acts that took place inside the red zone. Grossman did not offer any evidence to the contrary. Grossman also did not offer any evidence that would suggest the pre-red zone misconduct is unrelated to the misconduct that occurred inside the red zone. Accordingly, the continuing violations exception to the statute of limitations applies in this proceeding, and the Law Judge may properly include all of Grossman's misconduct as part of the Division's requested third-tier civil penalty in the amount of $3,407,765.66.

B. Grossman Failed To Properly Disclose The Fees And Compensation He Received Under The Referral And Consulting Agreements

In his Response Brief, Grossman contends he disclosed the fees and compensation paid to him under the Referral and Consulting Agreements in Sovereign's Form ADVs Parts 1 and II, Sovereign's investment advisory agreement, and in the private placement memoranda and subscription agreements[10] for the Anchor Hedge Fund and the FuturesOne Diversified Fund ("FuturesOne"). (Response Brief, at 23.) He also contends he verbally disclosed the fees to Sovereign clients. (*Id.* at 24.) The evidence the Division introduced at the final hearing, however, shows otherwise.

1. The Impact Of The Deficiency Letter.

As a preliminary matter, Grossman contends after he received OCIE's deficiency letter on February 7, 2005, he revised Sovereign's investment advisory agreement ("IAA") and Form ADV Part II to state that Sovereign "may receive performance-based compensation from certain investment companies" and "may receive incentive or subscription fees from certain investments." (Response Brief, at 23.)

As the Division set forth in its Initial Brief, and as noted below, prior to these revisions neither the investment advisory agreement nor the Form ADV Part II contained ***any*** mention of the fees or compensation Sovereign received from Battoo, and the agreement and Form ADV Part II therefore were false and misleading. After the revisions, however, the investment advisory agreement and Form ADV Part II continued to be false and misleading because it was not that Sovereign "may receive" the fees and compensation, it was that Sovereign ***actually was*** receiving them.[11] Indeed, courts routinely have held that the word "may" when used as a substitute for the fact that a party

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[10] 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.)

[11] The Division notes further the evidence presented at the hearing showed the first time Sovereign actually made these revisions in an attempt to correct the omissions identified in the deficiency letter was not until the Form ADV Part II that Sovereign prepared on August 22, 2006, and the IAA that Sovereign prepared in August 2006. (Tr. Vol. III at 851:16-24; 866:7-20.) This was approximately 18 months after the deficiency letter was sent.

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.*, *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985); *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).

2. The Form ADVs Parts 1 and II.

With respect to Sovereign's Form ADV Part 1, Grossman did not disclose the fees and compensation 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, 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.)

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.)

With respect to the Form ADVs Part II dated May 1, 2003 and February 12, 2004, in Item 8 of 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, 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, 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.)

For each subsequent Form ADV Part II that was in effect during Grossman's ownership of the company, he continued to make the same representations in Items 8, 9 and 13 described above. (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, he 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.) 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.)

The statements on Schedule F of these subsequent Forms ADV Part II 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, Grossman ***actually was*** 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, 112:1-4, 123:19-25, 124:1-18; DX 152 at 75:1-25, 76:1-13; DX 50 at ¶ 7.)

3. The Investment Advisory Agreement.

With respect to Sovereign's initial IAA effective as of August 6, 2003, Grossman omitted ***any*** mention of the fees and compensation paid under the Referral and Consulting Agreements. (DX 129.) 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 revised IAA was in effect, as noted above, Grossman ***actually was*** 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 under the Referral and Consulting Agreements. (Tr. Vol. I at 39:13-17, 41:9-13, 62:1-25, 111:22-25, 112:1-4, 123:19-25, 124:1-18; DX 152 at 75:1-25, 76:1-13; DX 50 at ¶ 7.)

4. The Private Placement Memoranda.

As the Division noted in its Initial Brief, the Battoo Funds consisted of FuturesOne, PIWM, and the Anchor Hedge Fund.

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.

With respect to PIWM, the due diligence questionnaire and materials Grossman distributed to Sovereign clients made no reference to Sovereign, Grossman or the fees and compensation 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.

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.*) With respect to Grossman himself, the PPMs identified him, along with Battoo, as a member of Anchor Hedge Fund's Investment Advisory Board. (DX 25 at 5; DX 28 at 5; DX 29 at 5; GX 28 at 5; GX 30 at 5.) However, with respect to fees, Section 4 of the PPMs provided that the investment manager (AHF Management) would be paid a fee, as well as the investment adviser who would be appointed by the investment manager. (*See* DX 25 at 16; DX 28 at 15-16; DX 29 at 16; GX 28 at 15-16; GX 30 at 16.) Grossman was not identified in any of the PPMs as an investment adviser (only as a member of the Investment Advisory Board) and at the hearing in this matter, Grossman denied giving

investment advice to the Anchor Hedge Fund. (Tr. Vol. I at 252:17-20; *see also* GX 14.) Accordingly, in his own words, Grossman could not have been acting as the investment adviser and therefore could not have been receiving the fee mentioned in the PPMs.

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 referral agreements. (*See id.*) In addition, while the subscription agreements 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.)

Accordingly, the PPMs and subscription agreements, therefore, did not disclose (and could not have disclosed) the fees and compensation paid under the Referral and Consulting Agreements. In addition, Grossman himself never disclosed to Sovereign clients that Battoo paid the 4.5% cost-of-entry fee to SIAM LLC. (Tr. Vol. I at 61:10-25; DX 152 at 42:18-25, 43:1-3.) 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.)

5. Verbal Discussions With Sovereign Clients.

Despite Grossman's contention in the Response Brief that he verbally disclosed the fees and compensation to Sovereign clients, the evidence the Division introduced at the final hearing showed otherwise. Indeed, Sovereign clients testified Grossman never disclosed any of the fees and compensation to them. (Tr. Vol. I at 39:13-17, 41:9-13, 62:1-25, 111:22-25, 112:1-4, 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.) In fact, Grossman's

own witness, C.W. Gilluly, testified Grossman not only did not disclose the fees and compensation being paid to him under the Referral and Consulting Agreements, he also failed to disclose the Referral and Consulting Agreements even existed. (Tr. Vol. II at 554:4-23.)

Instead, Grossman told clients the fees were a required "pay to play" admission that clients would pay directly to the fund. (Tr. Vol. I at 40:20-25; 41:1-2; 61:10-25.) And as for the 4.5% cost-of-entry fee, Gilluly (who acknowledged he was sophisticated with investing), testified he was aware of the cost-of-entry fee as a general matter, which he admitted was a customary fee for most hedge funds, but he testified Grossman never disclosed to him that Battoo actually paid the fee to Grossman. (Tr. Vol. II at 552:24-25; 553:1-5, 13-17; 530:20-22.) After finding out that Battoo paid the fees and compensation to Grossman, Sovereign clients considered that to be a conflict of interest. (Tr. Vol. I at 63:2-5.)

Aside from Gilluly (who, as noted above, testified Grossman never disclosed that he himself received the fees and compensation from Battoo), Grossman failed to identify at the hearing a single investor to whom he allegedly made the disclosures. Grossman was represented by competent counsel, and could have proffered such testimony to corroborate his position. Failing that, the Division's proffered testimony remains uncontroverted.

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

Despite his contentions to the contrary (Response Brief, at 25-26), Grossman clearly misrepresented the Anchor Hedge Fund to Sovereign clients and wholly failed to perform due diligence or investigate red flags concerning the fund.

1. Cross-Portfolio Liability.

In his Response Brief, Grossman claims the Division introduced no evidence at the final hearing of the risk associated with the various share classes of the Anchor Hedge Fund. (Response Brief, at 25.) The record, however, belies that claim. The Division showed the PPMs for Anchor

Hedge Fund Classes A and B (the market neutral classes) described the investments as moderately risky with goals of long-term capital appreciation and preservation. (DX 28 at 1-2; DX 29 at 1-2.) The Division also showed Sovereign described Classes A and B as having capital preservation as their primary goal. (DX 50F at 18-19.) Contrary to these statements, however, Classes A and B, 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.)[12] As a result, the investments in 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.) Accordingly, despite Grossman's contention to the contrary, the Division introduced evidence of the risk associated with the various share classes of the Anchor Hedge Fund.

Grossman also contends that the "risk disclosures in each of the Anchor Hedge Fund Private Placement Memoranda may have already taken into account the cross-portfolio liability between the Anchor Hedge Fund share classes." (Response Brief, at 25.) Grossman points to no record evidence (and in fact he introduced no such evidence at the hearing) to substantiate that proposition. Instead, even a mere cursory review of the PPMs for Classes A and B reveals the cross-portfolio liability associated with the share classes was never disclosed. (*See* DX 28; DX 29.)

Grossman further argues the Division did not introduce expert testimony rendering an opinion as to the statements made in the financial statements for the Anchor Hedge Funds. (Response Brief, at

[12] Grossman introduced no evidence at the hearing that he provided Sovereign clients with the financial statements or that clients ever actually received or reviewed them.

25.) Grossman cites no case law or other precedent indicating that expert testimony is needed on this issue. To the contrary, it is well-established in Commission administrative proceedings that expert testimony is unnecessary on matters of law, as Law Judges have the necessary expertise to decide the issues in dispute. *See, e.g.*, *In the Matter of Barry C. Scutillo*, AP File No. 3-9863, 2003 SEC LEXIS 1777, at *26 (July 28, 2003) ("We have made it clear, however, that neither a law judge nor this Commission requires expert testimony on questions of law"); *In the Matter of Pagel, Inc.*, AP File No. 3-6142, 1985 SEC LEXIS 988, at *16-17 (Aug. 1, 1985) ("The law judge, who is highly sophisticated in securities matters with many years of experience in determining issues under the securities laws, clearly had the necessary expertise to determine from the evidence whether or not respondents had manipulated the market for FTC.") Accordingly, the Law Judge can decide as a matter of law the financial statements revealed the cross-portfolio liability of the various share classes of the Anchor Hedge Fund while the PPMs and other offering materials Grossman provided did not. As noted above, Grossman provided no evidence at the final hearing that Sovereign clients ever received or reviewed the financial statements.

2. Diversification of Anchor Hedge Fund Class A.

Grossman contends the Division introduced no evidence at the final hearing Anchor A was not independently administered and audited. (Response Brief, at 25.) This is simply not true. The Division showed the PPM for Anchor Hedge Fund Class A did not disclose that Folio Administrators (the supposed independent fund administrator) 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.) The Division demonstrated, however, that 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, the Division showed 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.)[13] He also knew Keuls worked for Battoo. (*Id.* at 213:8-14.)

The Division's evidence also demonstrated that Class A 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.) Grossman reviewed the independent auditor's reports 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).

In his Response Brief, Grossman cites *Gabriel Capital, L.P. v. Natwest Finance, Inc.*, 137 F. Supp. 2d 251 (S.D.N.Y. 2000) for the proposition that he was entitled to rely on the accuracy of the independent auditor's reports and the PPM in recommending Class A to Sovereign clients and that as an investment adviser, he was not required to assume the role of private investigator to determine the accuracy of the documents. He also contends *Gabriel Capital* supports his failure to conduct further

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[13] 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.)

due diligence into Anchor Hedge Fund after Battoo stopped providing him with information about the underlying funds (even though Battoo had been doing so for years).

Grossman's reliance on *Gabriel Capital* is misplaced. Here, unlike *Gabriel Capital*, the investment adviser (Grossman) knew full well the fund was not independently audited and administered (in light of the interplay among Folio, Fiduciary Group Limited, Cann and Keuls). In that situation, 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). The fact that Folio, Fiduciary Group Limited, Cann and Keuls were all interrelated and the fact that Battoo stopped providing Grossman with information about the underlying funds were serious red flags.[14] Such red flags give rise to a securities professional's duty to investigate those flags, and ignoring them 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

[14] Given that Grossman previously had acted as IRA administrator for a number of clients who invested with Banyan Asset Management, which turned out to be a Ponzi scheme, he claimed that based on that experience, 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. (*Id.* at 353:12-21.) The irony here, of course, is that Anchor Hedge Fund was tied to Madoff, the largest Ponzi scheme in history.

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*, AP File No. 3-10595, Advisers Act Release No. 1978, 2001 WL 1148155 (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, 2009 WL 1077451 (Apr. 22, 2009) (investment adviser owes fiduciary duty to conduct due diligence as represented).

3. Redemptions of Class C.

With respect to the delay in processing Sovereign clients' redemptions of their shares in Anchor Hedge Fund Class C, Grossman contends that Sovereign clients consented to the delay in signing the fund paperwork, and as a result, he did not ignore any red flags. (Response Brief, at 26.)

Notably, Grossman does not deny, nor did he introduce any evidence at the final hearing disputing, that he was aware of the delay in processing the redemptions. Instead, his entire argument is based on the schedule for processing redemptions of Class C set forth in the PPM. Grossman, however, inaccurately describes the schedule.

According to Grossman, redemptions are processed at the end of the calendar quarter and must be received at least 45 days prior to the end of the quarter. (Response Brief, at 26.) Here, Urs Buehler requested a redemption on April 16, 2008. (DX 99 at 2.) For some reason, Sovereign delayed in processing the request until May 16, 2008. (*See id.*) However, either request date (April 16 or May 16) would still be 45 days prior to the end of the quarter, which was June 30, 2008. (DX 25.) Accordingly, Buehler's request was timely. To sidestep this fact, Grossman argues that even if the request was timely, it still would have been dependent on the net asset valuations for Anchor Hedge

Fund Class C's fund-of-funds underlying investments, which he claims would have taken "an additional ten weeks" to process. (Response Brief, at 26.) Grossman overlooks the fact, however, that Class C was not a fund of funds. Instead, its sole investment was a structured note. (*See* DX 25 at 1.) Grossman offered no evidence at the final hearing as to why the valuation of a structured note would take ten weeks to complete.[15]

Indeed, the Law Judge observed the problems with Grossman's explanation of the events giving rise to the delay in redemptions:

> Well, could I just ask, I know you have – you don't recall a lot, but my goodness, you were – you put people into these investments, and these people were waiting from 6/30/08, according to this, and this is October 14th, 2008. I mean, wouldn't that be something that you would be concerned about for your clients

(Tr. Vol. II. 337:13-19). The Law Judge went on to note:

> But my God, you were running a business and putting people into these things and you say you didn't remember talking with you – what looks like your primary – one of your primary people in your business whether your customers were waiting four or five months to redeem their investments

(Tr. Vol. II 338:4-10). Despite the problems Sovereign clients encountered with the redemptions, 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 the 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.) And Adams himself also testified that before he purchased Sovereign on October 1, 2008, 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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[15] Even if ten weeks were a reasonable time period to calculate a valuation for a structured note, Buehler was still waiting for a redemption well beyond the ten-week period. Indeed, the evidence the Division introduced at the hearing reflects the redemption was still pending as of October 14, 2008 (which was approximately 20 weeks after Sovereign processed the redemption request on May 16, 2008) (*see* DX 100 at 1.)

Accordingly, Grossman clearly ignored a red flag with the redemptions of Class C, and his arguments to the contrary should be rejected.

D. **<u>The Division Showed A Causal Connection Between Grossman's Violations Of The Securities Laws And The Amount To Be Disgorged.</u>**

Grossman argues in his Response Brief the Division's disgorgement 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. (Response Brief, at 27.)

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; *see also* DPFF 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. (Tr. Vol. II at 612-13, 617:5-8; DX 153; DX 154; DX 75.) 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). (Tr. Vol. II at 376:21-25; 377:1-2.)

In addition, it was not necessary, as Grossman contends, for the Division to call as witnesses every single Sovereign client who invested in the Battoo Funds and PIWM. In his Response Brief,

Grossman cites *Blatt*, 583 F.2d 1325, *SEC v. Manor Nursing Centers*, 458 F.2d 1082 (2d Cir. 1972), 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.[16] 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. In this case, 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

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[16] 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.

agreements for the Anchor Hedge Fund and FuturesOne. These same documents would have been provided to all Sovereign clients.

E. Grossman Cannot Offset A Disgorgement Award By Settlement Payments To Sovereign Clients Or By Penalties Imposed By The IRS

Contrary to Grossman's argument in his Response Brief, he ***was*** required to plead set off as an affirmative defense in response to the Division's claims. Failing that, Grossman has waived the defense as a matter of law.

Rule 220(c) of the Commission's Rules of Practice states very clearly that "[a] defense of res judicata, statute of limitations ***or any other matter constituting an affirmative defense*** shall be asserted in the answer." (emphasis added). Law Judges have held unequivocally that a failure to plead an affirmative defense in the answer constitutes a waiver. *See In The Matter of Philip A. Lehman*, AP File No. 3-11972, 2006 SEC LEXIS 659, at *13 (Mar. 20, 2006) (holding that because respondent failed to plead an affirmative defense, "he has thus waived the issue"); *In The Matter of George J. Kolar*, AP File No. 3-9570, 1999 SEC LEXIS 2300, at *71 (Oct. 28, 1999) ("Affirmative defenses must be pled in an answer or they are waived.") Here, Grossman was represented by very competent counsel who had the opportunity to plead set off as an affirmative defense along with the other ***eight*** affirmative defenses they interposed. And the law with respect to set off of a settlement payment in particular is well-settled. *See Garrison Realty, L.P. v. Fouse Architecture & Interiors, P.C.*, 546 Fed. Appx. 458, 465 (5th Cir. 2013) ("an offset due to a settlement credit is an affirmative defense that must be pleaded and proved by the defendant"). Indeed, without pleading the nature of the defense and sufficient facts in support, the Division would be prejudiced insofar as it would have no opportunity to prepare for the defense or to introduce any evidence to contradict the facts Grossman would offer in support. Accordingly, it is for good reason the Commission ***affirmatively requires*** respondents to plead affirmative defenses, and will find a waiver of the defenses if respondents do not include them.

Grossman also contends (assuming his failure to plead set off is not fatal to his defense, which, as noted above, is not the case) he presented sufficient evidence of set off in the form of settlement payments Sovereign made to clients and by the tax liability he paid to the IRS. (Response Brief, at 28.) First, as the Division noted in its Initial Brief, the law is clear that under no circumstances can a respondent offset a disgorgement award by the tax liability he owes to the IRS. *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).

And second, contrary to Grossman's contention, he failed to present sufficient evidence of the settlement payments. Where, as here, the 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 or testimony 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. Without that evidence, the Law Judge cannot determine the propriety of the defense. Accordingly, Grossman failed to meet his burden on this issue, and the disgorgement award therefore cannot be subject to any kind of offset.

F. The Law Judge Should Assess A Full Third-Tier Pecuniary Gain Civil Penalty Against Grossman.

The Law Judge should assess a full third-tier pecuniary gain penalty against Grossman in the amount of $3,407,765.66. As the Division noted in its Initial Brief, Grossman's conduct was egregious and recurrent, and he demonstrated a high degree of scienter. He also has never accepted

responsibility or shown remorse for his actions, even going so far as, for example, to defend the charges against him on the Class C redemptions by blaming Sovereign clients and arguing in effect "you signed the papers, so you should know better."

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 act as a deterrence against 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 his pecuniary gain ($3,407,765.66) is an appropriate penalty to impose in this proceeding.

III. CONCLUSION

For the foregoing reasons, and for the reasons set forth in the Division's Initial Posthearing Brief, 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 charges, and we ask the Law Judge to enter a cease-and-desist order; industry bar; disgorgement in the amount of $3,407,765.66 plus prejudgment interest; and a third-tier civil penalty in the amount of $3,407,765.66.

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