UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDING
File No. 3-16344

In the Matter of

EDGAR LEE GIOVANNETTI,

Respondent.

RESPONDENT'S POST-HEARING BRIEF

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I. Introduction.

The Division of Enforcement ("Division") contends that Respondent Edgar Lee Giovannetti ("Giovannetti") violated Sections 206(1), 206(2), and 207 of the Investment Advisers Act of 1940 ("Advisers Act"), and aided and abetted and caused violations of Section 207 of the Advisers Act by Consulting Services Group, LLC ("CSG"), a formerly Commission registered investment adviser.

Throughout this proceeding, Giovannetti has acknowledged that he should have written a letter to his clients immediately informing them of his indebtedness to Argonaut and the resulting conflict of interest created by the indebtedness and that he should have informed CSG's Chief Compliance Officer of the indebtedness so that CSG's compliance department could do what needed to be done. His defense to this action is to explain the circumstances giving rise to his failures and that the sanctions being sought by the Division are unduly harsh under the circumstances.

II. Summary of Facts.[1]

Mr. Giovannetti agrees with the Division that he should have made the disclosures that Mr. Balsmann told him to make when he discovered in September 1, 2009 that Argonaut was not repaid. He failed to make the disclosures as instructed by Mr. Balsmann to the Canales, Spence Wilson and Mr. Starnes on August 5, 2009 because at that date, he thought Argonaut had been paid in the redemption process. He failed to make the disclosures to them after September 1, 2009, when he discovered the Argonaut indebtedness was outstanding. His neglect to disclose the matter, as Mr. Balsmann had told him he should, occurred at the time of his absorption under the mandate he had received to save the business that was in a massive downward spiral following the harsh publicity of the New York lawsuit.

Mr. Giovannetti does not blame or fault either the Division for having filed the New York State action that mentioned CSG, but did not join it as a party, or the professional compliance personnel at CSG for his failure to disclose the Argonaut indebtedness.

He does not believe he is at fault for the language used in the August 24, 2011 ADV disclosure of the existence of the debt. He asserts that the material facts were known to the CSG compliance personnel who drafted the form ADV (Ex. 15) and that the choice of language was selected by them. Such personnel acknowledged that each read the promissory note at issue and knew, among other things: the original maturity date; it had not been paid on that date; and the post maturity interest rate of eight (8) percent. They also knew that when the note was issued on April 22, 2009, it was related to a request for redemption of Mr. Giovannetti's Argonaut investment. They knew the identity of the promissee. They also knew that Mr. Giovannetti had reported to the CSG compliance department two years beforehand that he had paid the note and that he had stated in his interview with the SEC earlier that month that the loan had not been

[1] Citations to Respondent's Proposed Findings of Fact are referred to as (FF #).

paid. The CSG ADV filings were signed by the Chief Compliance Officer and not by Mr. Giovannetti. The Chief Compliance Officer did not consult with Mr. Giovannetti in drafting the Form ADV. Mr. Giovannetti had no training in the compliance function of preparing the ADV forms. (FF B. 1)

CSG did not have discretion over clients' funds and did not make investments for them. CSG's business was to recommend money managers to clients. Such recommendations could come only after the firm's research advisory board thoroughly reviewed information about the money managers and approved the recommendations. Mr. Giovannetti was not permitted to make unilateral recommendations to clients that had not been properly approved in advance. Mr. Giovannetti did not receive incentive compensation, commissions or bonuses from client investments. (FF A. 8)

In April, 2009, Mr. Giovannetti requested a $50,000.00 draw down on his investment in the Argonaut Global Fund which was declined because of timing. That day Argonaut offered to lend him $50,000.00 to be paid back in three months either directly or from redemption. The promissory note did not contain those terms, but the email that forwarded the note to him gave him the choice to "pay this back directly or via a partial redemption." All of the email correspondence regarding the transaction ties to the redemption concept. Mr. Giovannetti's understanding that the funds were essentially an advance against his personal investment is consistent with the communications between him and Argonaut. (FF A.1)

On March 19, 2009, the SEC filed suit in the United States District Court for the Southern District of New York and mentioned but did not name CSG as a party. The allegations were that State officials did not disclose payments made to an individual employed by an investment advisory firm and that CSG was one of the companies that made such payments. The

allegations of pension fund abuse generated massive negative publicity that damaged CSG and its owners. Within a week of receipt of a Wells Notice, CSG delivered to the SEC a complete exposition of the many disclosures it had made regarding payments issued in New York and to whom they were made. CSG requested immediate action in the case to stem the developing damage to the company. (Ex. ELG 8) Three years later a termination letter was sent to CSG with no charges against the company. During that time, CSG undertook and implemented expensive and time consuming efforts to combat the allegations and publicity generated by it. Mr. Giovannetti was tasked by the owners with preserving client relations, shoring up employee morale and running the business. At the same time, in order to preserve capital for the defense of the case, the owners of CSG ceased distributions to themselves. That decision significantly impacted Mr. Giovannetti to the point of personal financial ruin. (FF A.4, FF A.9.c)

Mr. Giovannetti's assignment to protect the firm included the obligation to curtail the distribution of negative information about CSG. (FF A.9.c) His requests to keep negative financial information private were intended to protect CSG, not to hide the existence of the Argonaut transaction from regulators or clients. Such privacy requests were not intended as deceptions. (FF A.5) Mr. Giovannetti's emails that were marked private or confidential were, like all others of his emails, distributed through the CSG electronic system which was subject to a sophisticated compliance department review program. He was not only aware that the email system was subject to routine surveillance he knew that in fact the Argonaut promissory note was brought forward through those devices. (FF A.14)

In August of 2009, Mr. Giovannetti reported to Mr. Balsmann that Argonaut had been paid. The details about why he believed that at the time are set out at FF A.6 and A.10. Mr. Balsmann directed him to send letters to three client relationships (Canales, Wilsons and Starnes)

if the note was not paid because of a potential conflict of interest by his having borrowed money from Argonaut, a money manager of the Flagship Fund in which those clients were invested. (FF A. 11 and A. 12) The three clients, all sophisticated investors, had a long time relationship with Argonaut and its founder, Mr. Gerstenhaber, who had performed exceptionally well in the Flagship Fund. (FF A.9, FF A.11.f) Argonaut, Mr. Gerstenhaber and the Flagship Fund have been outstanding investments for CSG's clients. (FF A.7)

In September of 2009, Mr. Giovannetti learned that the note was not paid. His first thought was to find a way to pay the debt. He acknowledges that he did not think to send the letters to the three clients. He also acknowledges that he should have done so, but his thoughts, at the time, were consumed by trying to save the firm. It is further likely that the task of writing the three letters was not foremost on his mind due to his knowledge of the long-term relationship between the clients and Argonaut, their level of sophistication and the exceptional performance of the Flagship Fund. Whatever the reason, he did not think to tell them. Not doing so was a clear error on his part. (FF A. 13 and A.15)

In August, 2011, Mr. Giovannetti testified before the SEC that the Argonaut debt was not paid. The CSG compliance department immediately conducted an investigation and drafted, filed, and sent to the firm clients the form ADV disclosing the non-payment. (FF B. 1)

Throughout the trial, the Division raised issues to imply intent on Mr. Giovannetti's part to deceptively withhold disclosure of the Argonaut debt. Mr. Giovannetti staunchly denies any such intent. There is not sufficient space to address each such issue, but the following addresses some of them:

- In February, 2010, Mr. Giovannetti reviewed a financial statement with Mr. Balsmann that did not show the Argonaut loan. However, the financial statement

was prepared to compare his assets with commercial/bank debt owed by him. It was reviewed by him and Mr. Balsmann because of the demand by two commercial banks for immediate payment by him of nearly $500,000.00. The financial statements were not prepared to demonstrate non-commercial/non-bank debt obligations. Many other items were not shown on them, including taxes and guaranty liabilities. The matter was not related to Argonaut. (FF B.3)

- At a client meeting in Memphis in May, 2009, Mr. Giovannetti introduced Argonaut's Mr. Gerstenhaber, who was a presenter at the conference, to prospective clients, and set up meetings between him and other clients with whom Mr. Gerstenhaber had a long-standing relationship. This effort on Mr. Giovannetti's part was not a *quid pro quo* in exchange for what he viewed at the time as an advance on his own money. It was an effort to shore up client confidence in the face of devastating publicity immediately following the filing of the New York Suit. (FF A. 9)
- At the same May client meeting, Mr. Giovannetti did not disclose to clients that he had received the funds that, in May of 2009, he viewed as an advance. At that time, he did not understand a disclosure was appropriate because he did not consider the advance on his own investment account a potential conflict of interest. (FF A.9)
- In 2008, Mr. Giovannetti introduced Ms. Kristi Jernigan, a Memphis friend, to Mr. Gerstenhaber who ultimately hired her. At the time, well before the April, 2009, Argonaut loan, Mr. Giovannetti told them he would help her develop industry relationships. Mr. Giovannetti from time to time introduced her to

persons, some of whom were CSG client relationships and some of whom were not. His doing so was not a *quid pro quo* in exchange for the Argonaut agreement. She considered him a superstar and he considered her as having great potential. He was helping a friend. (FF A.9)

- Mr. Giovannetti's decision to not meet with his partners at the time of the effort to enlist them to financially assist him in restructuring his commercial/bank debt in February, 2010 to avoid personal bankruptcy, was based on the belief that they could better discuss the matter without him present. It was an emotional issue and had nothing to do with Argonaut. (FF B.4)
- Mr. Giovannetti did not tell Ms. Lawson in February or March that the Argonaut loan had been paid. Her initial statement at trial was that there was no mention of Argonaut at the time. Also, no documents or other witnesses mention the making of such a statement. And documents prepared by Ms. Lawson, immediately after the loan was disclosed by Mr. Giovannetti, do not mention it. (FF B.50)
- Mr. Giovannetti's statements in a Memorandum dated October 10, 2011 that he had recently been able to pay the note ended up being incorrect. However, he specifically sent to Mr. Nummi for review before distribution further. It turned out that the arrangements believed by Mr. Giovannetti to be in place, were not. Mr. Nummi was engaged in trying to negotiate a method for payment of the note and made statements that led Mr. Giovannetti to believe a payment plan had been arranged. Mr. Nummi confirmed that Mr. Giovannetti's belief was warranted. There was no intent to deceive. (FF C.1)

- In 2013, Mr. Giovannetti recalled in testimony before the SEC that the fluctuating differences between the Argonaut Global Fund and the Flagship Fund framed the reason for his belief that the redemption in July, 2009 had covered the amount due on the note. While there had been marked differences between the two funds, his basic recounting of the circumstances of four years earlier was in error. At trial Mr. Giovannetti explained that he had not remembered the situation correctly due to the passage of time. Regardless, the statement was made two years after the disclosure to the SEC of the unpaid obligation and has no bearing on the disclosure issue. Mr. Giovannetti testified that at the time he made the statements he believed them to be true as he remembered the events. (FF C.2)

The Argonaut Flagship Fund in which the clients were invested was nationally recognized for its exceptional performance and no client suffered losses because of investments in it. Mr. Giovannetti received no commissions because the firm continued to recommend Argonaut to clients. These facts do not excuse non-disclosure, but they have significant bearing on Mr. Giovannetti's intent to assist and not to harm clients. (FF A.7)

Finally, and most importantly, Mr. Giovannetti, who is now without a job and whose company no longer exists, has fully confirmed that he has understood all along that he owes high fiduciary duties to his clients and that includes the duty of full disclosure. (FF C.3, FF D) He would like to keep his license in the only profession he has known for over thirty years under any conditions the court would see fit in impose.

III. Argument.

A. Section 206 of the Advisers Act.

There is no dispute that Section 206 of the Advisers Act requires an investment adviser to disclose conflicts of interest which might incline an investment adviser to render advice which is not disinterested. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 184, 191-192 (1963). The failure by an investment adviser to disclose a conflict of interest constitutes a violation of Section 206. Montford & Co., Inc., Advisers Act. Rel. No. 3829, 2014 WL 1744130 at *13 (May 2, 2014) (Commission Opinion). If the failure to disclose a conflict of interest is done without scienter, the conduct violates Section 206(2). Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd. on other grounds, 450 U.S. 91 (1981). If the failure to disclose a conflict of interest is done with scienter, the conduct violates both Section 206(1) and 206(2). Vernazza v. SEC, 327 F.3d 851, 860 (9th Cir. 2003).

Scienter is defined as a mental state consisting of an intent to deceive, manipulate or defraud. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976). Reckless conduct satisfies the scienter requirement. Vernazza v. SEC, 327 F.3d at 860; SEC v. Blavin, 760 F.2d 706, 711-12 (6th Cir. 1985). With respect to the antifraud provisions of the Exchange Act, recklessness has been described as an extreme departure from the standards of ordinary care, which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it. See Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977), cert. denied, 434 U.S. 875 (1977).

1. Giovannetti did not Violate Section 206(1) of the Advisers Act Because he did not Act with Scienter.

In February 2007, CSG hired Ed Balsmann as its General Counsel and Chief Compliance Officer and charged him with updating the firm's policies and procedures so that the firm's

operations would be in compliance with the various governmental and self-regulatory authorities that regulated CSG's business.[2] Shortly after Mr. Balsmann was hired, CSG and its former Chief Compliance Officer entered into a cease-and-desist order which found that CSG had, among other things, failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder and that CSG's former Chief Compliance Officer had willfully aided and abetted and caused such violations.[3]

Balsmann quickly became aware that CSG's business model included numerous conflicts of interest and potential conflicts of interest which require a significant amount of his time and attention.[4] Balsmann brought in experienced compliance personnel to assist him and is proud of the work he performed at CSG.[5] Balsmann was supported by all of the owners of CSG, including Giovannetti, in his efforts to improve the compliance policies and procedures at CSG.[6]

In August 2009, Balsmann learned that Giovannetti had signed a written promissory note in favor of Argonaut[7] and wrote Giovannetti a memo stating that "[W]hile CSG's Code of Ethics does not specifically restrict borrowing money from investment managers, the borrowing of money by CSG employees from investment managers that manage CSG client assets creates a potential conflict of interest. . . ."[8] Balsmann advised Giovannetti that if the indebtedness in Argonaut was still in place, then a brief written disclosure to the clients that Giovannetti works with that invest in Argonaut would be in order.[9] Balsmann never informed Giovannetti that it

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[2] Tr. 548.
[3] Tr. 547-48.
[4] Tr. 549-56.
[5] Tr. 554-55.
[6] Id.
[7] Balsmann learned of the promissory note from routine review of electronic mail communications by the compliance department as part of the compliance and supervision program of the firm. All employees were educated about the role of the compliance department and knew that the compliance department reviewed e-mails of all employees on at least a monthly basis.
[8] DOE 316.
[9] Id.

would be necessary to make a disclosure of his indebtedness to Argonaut and the resulting conflict of interest in CSG's Form ADV.

Giovannetti responded to Balsmann that he had redeemed his investment with Argonaut and paid the Argonaut loan off.[10] Although Giovannetti believed that Argonaut had paid the loan from his redemption proceeds and had sent him the remaining balance of the proceeds, in fact, Argonaut had not applied a portion of the redemption proceeds to pay the loan. When Giovannetti learned that his indebtedness to Argonaut had not been paid from his redemption proceeds, he failed to make the written disclosure to the three clients that Balsmann had advised was necessary and he failed to inform Balsmann that his indebtedness to Argonaut was still in place. At that time, Giovannetti did not think to make the disclosures or inform Balsmann that the indebtedness had not been paid because of the relentless pressure of managing CSG through the turmoil created by the New York State matter and the fight for the firm's survival which had consumed him.[11]

Engulfed in the struggle for the survival of the firm he co-founded, he failed to focus on his duty to disclose the conflict that his indebtedness to Argonaut created. Giovannetti's mental state was on preserving his firm and the livelihood it provided for its 60 employees and not on an intent to deceive, manipulate or defraud the firm's clients. Balsmann had advised Giovannetti to make a brief written disclosure to the his three clients that invest with Argonaut if his indebtedness to Argonaut was still outstanding. Each of the three clients that Giovannetti worked with that had investments with Argonaut were longtime clients and friends of Giovannetti and had been investors with Argonaut for many years.[12] Two of the clients had

[10] DOE 320.
[11] Tr. 207-08, 227-28, 236.
[12] Tr. 1119-25.

known David Gerstenhaber, the manager of Argonaut's investment funds, for at least ten years.[13] As these clients had determined to invest with Argonaut long before Giovannetti became indebted to Argonaut, it is difficult to envision that Giovannetti's $50,000 indebtedness to Argonaut would have influenced any of these clients' decisions to continue their investment relationship with Argonaut. Giovannetti's failure to follow Balsmann's directive was one of negligence and not one driven by an intent to deceive or defraud his clients and friends.

Giovannetti's disclosure of the Argonaut indebtedness and the resulting conflict of interest to his three clients was not all that was required to satisfy the requirements of Section 206. Giovannetti's indebtedness to Argonaut and the resulting conflict of interest needed to be disclosed to all of CSG's clients and prospective clients in the firm's Form ADV. However, Balsmann did not inform Giovannetti of this requirement and Giovannetti, not having expertise in compliance issues, failed to appreciate the need to inform all of CSG's clients and prospective clients of his indebtedness to Argonaut and the resulting conflict of interest. Consequently, Giovannetti failed in his duty as an investment adviser to ensure that disclosure of this conflict of interest was timely made in the firm's Form ADV. But Giovannetti's failure is not an extreme departure from the standards of ordinary care as CSG's Chief Compliance Officer, the person who had the responsibility for preparing, signing and filing CSG's Forms ADV, had advised Giovannetti that disclosure of the conflict of interest should be made to the clients he worked with that had invested with Argonaut and did not advise Giovannetti of any action to be taken to disclose the conflict to other CSG clients and prospective clients whether through disclosure in the firm's Form ADV or otherwise.[14]

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[13] Id.

[14] Balsmann testified that had Giovannetti confirmed that his indebtedness to Argonaut was still in place, he would have amended CSG's Form ADV to disclose the conflict of interest. Balsmann stated he had the responsibility for drafting and filing CSG's Form ADVs. In fact, Balsmann had submitted an updated Form ADV for CSG on August

2. Giovannetti is Liable for Violations of Section 206(2).

Giovannetti meets the broad definition of investment adviser under Section 202(a)(11) of the Advisers Act and investment advisers have a duty to disclose all material conflicts of interest in Forms ADV. Although Giovannetti had no personal expertise in disclosure matters and Balsmann did not advise Giovannetti of the duty to disclose the conflict of interest arising from his indebtedness to Argonaut in CSG's Form ADV, Giovannetti nonetheless had the duty to make the required disclosure of the conflict of interest to all clients and prospective clients of CSG. The duty required disclosure of the conflict of interest in CSG's Form ADV which was not made until August 24, 2011. The non-disclosure is a violation of Section 206(2) for which Giovannetti accepts responsibility.

B. Section 207 of the Advisers Act

1. Forms ADV filed prior to August 19, 2011.

Giovannetti acknowledges that the $50,000 loan from Argonaut resulted in a conflict of interest that should have been disclosed in CSG's Form ADV. Giovannetti further acknowledges that he mistakenly informed CSG's Chief Compliance Officer on August 8, 2009 that he had paid the loan off and that he did not inform CSG's Compliance that the loan remained outstanding until August 2011. Giovannetti accepts responsibility for the omission of any disclosure regarding the conflict of interest resulting from his loan from Argonaut in CSG's Forms ADV filed prior to August 19, 2011, the date he informed CSG's compliance personnel and SEC staff that the Argonaut loan had not been repaid and remained outstanding. Accordingly, CSG and Giovannetti violated Section 207 of the Advisers Act by failing to

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6, 2009, without review by Giovannetti, to disclose that CSG and its related persons may be investors in the same investment vehicles, mutual funds and money managers as recommended to CSG's clients but did not disclose that Giovannetti had obtained a loan from Argonaut. See DOE 321 and 7. August 6, 2009, was one day after Balsmann wrote his memo to Giovannetti inquiring about the current state of Giovannetti's indebtedness to Argonaut and two days prior to Giovannetti's response. See DOE 320.

disclose the Argonaut loan and the resulting conflict of interest on Forms ADV filed by CSG prior to August 19, 2011.

2. Forms ADV filed on August 24, 2011 and thereafter.

After Giovannetti informed SEC staff and CSG compliance personnel on August 19, 2011, that the Argonaut loan had not been repaid, CSG's Chief Compliance Officer, Miles Fortas, and CSG's Compliance Consultant, Rick Nummi, drafted the disclosure of the Argonaut loan that is contained in CSG's August 24, 2011 Form ADV.[15] Giovannetti did not participate in the drafting of the disclosure and did not edit the language prepared by Fortas and Nummi.[16]

The Division asserts that disclosure in the August 24, 2011 Form ADV is materially misleading because Nummi and Fortas characterized Giovannetti's loan from Argonaut "as an advance of a redemption related to his investment" with Argonaut. Although it was Nummi or Fortas that described the loan "as an advance of a redemption related to his investment" that is exactly what Giovannetti had expected and understood was to happen. Moreover, the use of the word "advance" in the disclosure is consistent with the plain and ordinary meaning of that word. Webster's Eleventh New College Dictionary defines advance as follows:

> vb. . . 7: to supply or furnish in expectation of repayment
>
> n. . . 5: a provision of something (as money or goods) before a return is received; *also*: the money or goods supplied

Giovannetti believed that Argonaut had advanced him $50,000 in April 2009 that he could repay via a redemption from his investment with Argonaut in July 2009. Giovannetti had sought to redeem $50,000 of his investment with Argonaut.[17] Jarrett Posner of Argonaut had confirmed that Argonaut could loan Giovannetti $50,000 which Giovannetti could pay back directly or via a

[15] ELG 15; Tr. 977, 1052, 1071.
[16] Tr. 978.
[17] DOE 220.

partial redemption.[18] Giovannetti had responded that he would pay the loan without redeeming unless he had no other options.[19] Later, Giovannetti submitted a request for a redemption of his entire investment[20] and assumed that Argonaut would pay the $50,000 loan from the redemption of his investment and remit the balance of the redemption proceeds to him.

More importantly, at the time that Nummi and Fortas prepared the August 24, 2011 Form ADV, they knew that Giovannetti had received a $50,000 loan from Argonaut in April 2009, that the due date of the note evidencing the Argonaut loan was July 20, 2009, that none of the redemption proceeds had been applied against the loan, that Giovannetti had redeemed his entire investment with Argonaut in July 2009, that Giovannetti had not repaid the Argonaut loan, and that the note evidencing the Argonaut loan provided for a default interest rate of 8 percent. Further, CSG compliance officers were "shocked" to learn that the Argonaut loan had not been repaid and knew CSG had an obligation to make disclosure of the Argonaut loan as quickly as possible.[21] Fortas confirmed there was no additional information CSG needed at that time to make an accurate disclosure in the Form ADV.[22] Nummi and Fortas drafted the disclosure of the Argonaut loan and filed the updated Form ADV without any input from Giovannetti. Giovannetti is not responsible for the content of that disclosure.[23]

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[18] DOE 221, 223.
[19] DOE 221, 222.
[20] DOE 255.
[21] Tr. 971-73.
[22] Tr. 976, 983.
[23] While CSG consented to the entry of an Order where the Commission found that the disclosure of the Argonaut loan and the potential conflict of interest in the August 24, 2011 Form ADV was false and misleading, CSG did not admit or deny the finding. The finding is not binding upon Giovannetti.

The disclosure of the Argonaut loan in CSG's Form ADV Part 2A, dated March 28, 2012 was identical to the disclosure in the August 24, 2011 Form ADV. For the reasons stated above, Giovannetti is not responsible for the content of the disclosure.[24]

IV. Appropriate Relief.

A. Factors in Determining Sanctions.

In determining whether sanctions are in the public interest, the Commission considers the Steadman factors: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations; and deterrence. Steadman v. SEC, 603 F.2d at 1140; Montford & Co., Inc., 2014 WL 1744130 at *18.

1. Mitigating Factors in this Case.

Caught between the Scylla of personal financial challenges caused by not receiving distributions from CSG and the Charybdis of the devastating effects that the New York Common Retirement Fund Complaint and subsequent Wells Notice had on CSG's business, Giovannetti failed to take affirmative steps to disclose that he had an outstanding loan from Argonaut and the conflict of interest created thereby. There are several mitigating factors the Court should consider in determining appropriate sanctions.

First, throughout this proceeding, Giovannetti has acknowledged that he should have timely written the three clients Balsmann had advised him to inform about the Argonaut indebtedness and that he should have timely informed Balsmann of the indebtedness. He has

[24] Giovannetti resigned from his position as CEO of CSG Holdings and from all management positions at CSG in December 2011.

accepted responsibility for his actions and recognizes that there must be consequences for his failures. During his testimony at the hearing, Giovannetti repeatedly stated that he understands that an investment adviser is a fiduciary and that he understands all conflicts of interest must be disclosed to clients and prospective clients. He offered assurances that such failures will not occur in the future.

Second, Giovannetti was not driven by a desire to conceal the Argonaut loan from CSG's compliance department or to defraud or injure CSG's clients. On September 1, 2009, Giovannetti instructed his assistant to inform Argonaut that he was aware that he had not yet made payment on the loan.[25] On several later occasions, Giovannetti requested Argonaut for additional time to pay the loan back or acknowledged that the loan remained outstanding.[26] All of these communications were through CSG's email and regular mail systems and were subject to review by CSG's compliance department.[27] Giovannetti's use of electronic and regular mail communications to acknowledge that the loan remained outstanding confirms that he was not seeking to conceal the loan.[28]

Third, Giovannetti informed SEC staff and CSG's compliance officers on August 19, 2011, that the Argonaut loan had not been repaid and remained outstanding.[29] It was this disclosure by Giovannetti that lead CSG's compliance officers to update CSG's Form ADV to disclose that Giovannetti had received a loan from Argonaut in 2009 that had not been repaid and

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[25] DOE 326.
[26] DOE 329, 339, 409.
[27] CSG's compliance department first learned on the Argonaut loan from a review of Giovannetti's electronic mail communications.
[28] Giovannetti does not suggest that it was CSG's compliance department's responsibility to detect that the Argonaut loan remained outstanding through its email surveillance technology or that he bears no responsibility for informing Compliance that the loan had not been repaid. Rather, Giovannetti's use of CSG's email and regular mail communications to request additional time to pay the loan and to acknowledge that the loan remained outstanding, while knowing that Compliance regularly reviewed electronic and regular mail communications, demonstrates that Giovannetti was not attempting to conceal from CSG's compliance department that the loan had not been repaid.
[29] Tr. 972-73, 1039.

the resulting conflict of interest. While this disclosure does not excuse Giovannetti's failure to inform CSG's compliance department when he first learned in September 2009 that the Argonaut loan had not been repaid, it does further evidence that Giovannetti was not attempting to conceal the existence of the loan.

Fourth, there is no evidence of any client of CSG losing any money by investing with Argonaut or that any financial harm or damage was suffered by any CSG clients, the investing public or the marketplace from Giovannetti's failures. There is no evidence of unjust enrichment of CSG or Giovannetti. The representatives of the MERS and FRS retirement systems testified that those retirement systems continued their investments with Argonaut after being informed that Giovannetti had received a loan from Argonaut.[30] Neither representative testified or even suggested that Giovannetti or CSG had been unjustly enriched from MERS' or FRS' investments with Argonaut.

2. **Bar or Suspension from Associating with any Investment Adviser.**

While the appropriate sanction depends on the facts and circumstances of each case and cannot be precisely determined by comparison with action taken in other proceedings,[31] an examination of the cases cited by the Division in its pre-trial brief demonstrates that the lifetime bar from the industry recommended by the Division would be unduly harsh in this case and would be "piling on" much like this Court held in Seaboard Investment Advisers, Inc., Adviser's Act Rel. No. 149, 1999 WL 735233 at *12 (Sept. 21, 1999) (Murray J.).[32]

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[30] Tr. 848, 879.

[31] See, e.g., Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Geiger v. SEC, 363 F.2d 481, 488 (D.C. Cir. 2004).

[32] Eugene Hansen was the founder, controlling shareholder, chairman, CEO and President of Seaboard Investment Advisers, Inc. Hansen was a learned, seasonal professional who the Court found to have made material misrepresentations to Seaboard clients and to industry regulators sufficiently egregious to merit the imposition of remedial sanctions. Despite finding that Hansen's actions were egregious, that Hansen denied any serious wrongdoing, that Hansen made no assurances that he will comply with federal securities laws in the future and that

In Gary M. Kornman, Adviser's Act Rel. No. 335, 91 SEC Docket 2687 (Oct. 9, 2007), Kornman was barred from association with any broker, dealer, or investment adviser after a finding that he had pled guilty to making a false statement to the Commission in violation of 18 U.S.C. § 1001, a felony conviction and was ordered to disgorge $143,465 of unjust enrichment. The Commission upheld the administrative law judge's imposition of a bar from the industry finding it is in the public interest to bar an individual based on a criminal conviction of misleading investigators during the course of their investigation. In the Matter of Gary M. Kornman, Adviser's Act Rel. No. 2840 (Feb. 13, 2009) (Commission Opinion).

In Montford and Co., Inc., Adviser's Act Rel. No. 457, 2012 WL 1377372 (Apr. 20, 2012) (Murray J.), Montford Associates affirmatively represented in its Form ADV filings that Montford Associates and related persons did not accept any fees from investment managers and Mr. Montford specifically told a client that Montford Associates was not paid by any investment manager. Despite these representations, Montford Associates received fees totaling $210,000 from an investment manager which Mr. Montford recommended to clients and Mr. Montford individually received other financial benefits from the investment manager. Mr. Montford never disclosed to clients that Montford Associates had received $210,000 of fees (comprising over 25% of the firm's annual revenues) from the investment manager he recommended to clients. Mr. Montford refused to accept that his conduct violated the Advisers Act, a factor that this Court highlighted for imposing a lifetime bar of Montford from the industry, a remedy which the Commission agreed was warranted under the facts of that case. Montford and Co., Inc., 2014 WL 1744130.

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it was likely that Hansen would continue to work for an investment adviser in some capacity, the Court imposed a suspension of twelve months rather than a lifetime bar from the industry.

In Feeley and Willcox Asset Mgmt. Corp., Advisers Act Rel. No. 165, 72 SEC Docket 1106, 2000 WL 628245 (May 16, 2000) (Murray J.), Mr. Feeley deliberately lied as part of a scheme to defraud unsophisticated clients in order to obtain funds needed to continue the operations of a company related to Mr. Feeley. Mr. Feeley exercised discretion over money that these unsophisticated clients had entrusted to him for their retirement to purchase $95,000 of debentures issued by his related company, a company which he knew was in a precarious financial situation but did not disclose to the clients. Mr. Feeley made false representations that the invested funds would be used to capitalize the related company to put it on a more sound financial basis and that the debentures would permit the clients to participate in the related company's growth at a time the related company was contracting its operations. In addition, Mr. Feeley committed a separate and distinct violation when he failed to disclose to his clients that he would earn a commission from any transaction that the clients executed through a brokerage firm Mr. Feely had recommended to the clients. This Court found that Mr. Feeley refused to accept facts that did not suit his purposes and barred Mr. Feeley from association with a broker, dealer, or investment adviser with the right to reapply in a non-supervisory, non-proprietary capacity after two years. The Commission upheld the bar finding that Mr. Feeley would not acknowledge the conflicts among his clients' interests, his own interests and his firm's interests that were patently present. Feeley and Willcox Asset Mgmt. Corp., 80 SEC Docket 1730, 2003 WL 22680907 at *14 (July 10, 2003) (Commission Opinion).

In contrast, this case does not involve a criminal conviction of an adviser, or the receipt of substantial fees from an investment manager by an adviser who affirmatively represented to his clients both in person and in his firm's ADV that the adviser does not receive payment from any investment manager, or discretionary purchases by an adviser for his unsophisticated clients

of debentures issued by an adviser-related company in deteriorating financial condition. Instead, in this case, Giovannetti failed to recognize that the advance of $50,000 he received from Argonaut created a conflict of interest that needed to be disclosed to his clients and in CSG's Form ADV and Giovannetti failed to timely advise CSG's Chief Compliance Officer that he was mistaken when he informed the Compliance Officer on August 8, 2009, that his indebtedness to Argonaut had been paid. However, unlike Messrs. Kornman, Montford and Feeley, Giovannetti was not unjustly enriched by his conduct, Giovannetti has acknowledged that his conduct is not acceptable, Giovannetti has accepted responsibility for his actions, and Giovannetti has offered assurances that such conduct will not occur in the future.

Giovannetti realizes that an investment adviser is a fiduciary and has a duty to disclose all conflicts of interest to his clients and prospective clients. Giovannetti realizes that he must give his full attention to compliance policies and procedures and that the public interest would be served by his suspension from being associated with an investment adviser for a period of twelve months, which he submits will be sufficient to protect the public and bring about future compliance.

3. **Cease-and-Desist.**

In determining whether to issue a cease-and-desist order, the Commission considers essentially the same factors as in Steadman. In addition, the Commission considers "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceeding." KMPG Peat Marwick LLP, Exchange Act Release No. 43862, 2001 SEC LEXIS 98, at *116 (Jan. 19, 2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002). The Commission weighs these factors in light of the entire record, and no one

factor is dispositive. Id.; accord Montford & Co., Inc. , 2014 WL 1744130, at *21. Giovannetti accepts responsibility for his conduct and, for the mitigating factors stated above, submits that the public interest would be served by the entry of a cease-and-desist order which he submits will be sufficient to protect the public and bring about future compliance.

4. **Civil Money Penalty**.

Section 203(i) of the Advisers Act permit civil penalties in proceedings instituted under Section 203(f) of the Advisers Act or in any cease-and-desist proceeding if, after notice and opportunity for hearing, a person was found to have willfully aided and abetted or caused a violation of the statute. The Section describes three tiers of possible penalties distinguishable by characteristics and maximum amounts.

The Division seeks second tier penalties against Giovannetti. Considerations used to determine whether a civil penalty is in the public interest include (a) whether the act or omission involved fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement, (b) harm caused to others, (c) unjust enrichment, (d) any previous regulatory or governmental determinations, (e) deterrence, and (f) such other matters as justice may require.

There is no evidence of any financial harm or damage suffered by any client or prospective client of CSG or by the investing public or in the marketplace. There is no evidence that Giovannetti acted with intent to benefit himself financially and there was no unjust enrichment. Giovannetti has repaid the Argonaut loan with interest from a withdrawal of funds from his account in CSG's 401(k) Plan.

CSG incurred substantial expenses to combat the allegations levied against it in the New York Retirement Fund Investigation while losing significant clients and employees because of

the allegations.[33] Although CSG eventually received a letter from the Securities and Exchange Commission confirming that no enforcement action would be recommended,[34] it came too late as CSG could not recover from the damage the allegations had caused. Eventually, CSG lost its battle to survive and withdrew its registration and ceased investment advisory activities on October 4, 2013.[35] Giovannetti resigned from his position as CEO of CSG Holdings and from all management positions of its registered operating subsidiaries, including CSG, in December 2011[36] and is unemployed.

In view of no unjust enrichment or harm caused to others, and his willingness to accept the imposition of a twelve month suspension and a cease-and-desist order to protect the public and bring about future compliance, Giovannetti submits that a civil money penalty is not necessary to protect the public.

5. **Disgorgement.**

As there is no evidence of unjust enrichment to Giovannetti or CSG, the Division does not seek disgorgement from Giovannetti.

V. Conclusion.

For all the reasons stated herein, Respondent, Edgar Lee Giovannetti respectfully requests the Court's consideration of the remedies proposed in this post-hearing submission.

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[33] Tr. 943, 946, 961-62; ELG 10, 11.
[34] ELG 9.
[35] ELG 15; Tr. 960-64.
[36] Id.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Undersigned Counsel for the Respondent hereby certifies that, on the date set forth below, he served RESPONDENT'S POST-HEARING BRIEF as follows:

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This 30th day of July, 2015.

Robert E. Orians
Attorney for Respondent Edgar Lee Giovannetti