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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16554

In the Matter of

GRAY FINANCIAL GROUP, INC.
LAURENCE O. GRAY, and
ROBERT C. HUBBARD, IV

DIVISION'S
PRE-HEARING BRIEF

Gray Financial Group Inc., an Atlanta-based registered investment adviser, and two of its senior officers violated the antifraud provisions of the federal securities laws by recommending and selling an unsuitable investment, its proprietary fund of funds, to four advisory clients. Between August 2012 and August 2013, Gray Financial, its founder Laurence O. Gray, and current CEO Robert C. Hubbard, IV, recommended, offered and sold investments in GrayCo Alternative Partners II LP ("GrayCo Alt II"), to four Georgia public pension advisory clients. GrayCo Alt II was created and sold subsequent to a July 2012 change in Georgia law which allowed, for the first time, most large Georgia-based public pension plans to invest in alternative investments, subject to certain specific restrictions. Among other restrictions, the statute required the alternative investment to have at least four investors unrelated to the issuer, and have $100 million invested or committed, before a Georgia pension plan could invest. The statute also provided that no Georgia pension plan could invest more than 20 percent of the funds in an alternative investment. Gray and Hubbard nevertheless put their Georgia pension fund clients into an investment (their own fund) that did not meet those requirements.

Beyond making sales that they knew to be in violation of Georgia law, Gray Financial and Gray also made specific material misrepresentations concerning the investment's compliance with the Georgia law and the number and identity of prior investors in the fund.

I. RESPONDENTS AND RELATED ENTITIES

A. Respondents

1. **Gray Financial Group, Inc. ("GFG" or "Gray Financial")**, an SEC-registered investment adviser, doing business as Gray & Company, is an Atlanta, Georgia-based investment adviser that has been registered with the Commission since 1998. It primarily provides advisory services to pension and profit sharing plans, endowments, and other entities. As of its most recent ADV filing, GFG has 20 non-discretionary accounts with approximately $3.8 billion in plan assets and 17 discretionary accounts with almost $1.2 billion in assets under management. Gray Financial also created and advises through GrayCo Global Advisors, a division of Gray Financial, two alternative investment fund of funds, GrayCo Alternative Partners I, LP and GrayCo Alt II.

2. **Laurence O. Gray ("Gray")** is the founder, owner, and former CEO of GFG. According to Gray Financial's Form ADV, Gray is also 75 percent or more owner of GFG. Since the Company's founding, Gray has been President and, until July 2013, was its CEO. At various prior times, though not during the relevant period, Gray has been associated with broker-dealers. In August 2011, a former client filed a lawsuit against GFG, Gray, and others in Fulton County, Georgia Superior Court. The matter was settled in March 2012, with Gray agreeing to pay $1 million to his former client on a schedule that required periodic payments throughout 2012 and 2013.

3. **Robert C. Hubbard, IV** has been employed by GFG since August 2006 in various senior positions. Prior to GFG, he was employed by Washtenaw County, Michigan

from 2000 to 2006 in various positions, including Retirement Administrator and Strategic Operations Manager. He was COO of GFG from October 2009 until July 2013, when, with another shareholder, he became co-CEO, a position he currently holds.

B. Related Entity

GrayCo Alternative Partners II, LP is a private fund of funds organized in Delaware. It filed a Form D with the Commission on December 20, 2012. The general partner and manager of GrayCo Alt II are both subsidiaries of GFG and are controlled by Gray. Gray and Hubbard are both members of GrayCo Alt II's executive committee. GrayCo Alt II currently has four limited partners/investors with $82 million in committed capital.[1] All four limited partners were GFG investment advisory clients at the time of their investments.

II. FACTS

A. GFG Begins as a Pension Consultant

Respondent Gray has been in the financial services business for over 30 years, beginning as a registered representative in 1984. In 1994 he founded Gray Financial Group, Inc. often doing business under the name "Gray and Company" or "Gray & Co." In 1994, Gray registered GFG as a Commission-registered investment adviser. Respondent Hubbard joined GFG in 2006 and became Chief Operating Officer in 2009. After the SEC began an examination of GFG in 2013, Gray stepped down as CEO and Hubbard became "co-CEO" with another GFG employee.

From its inception, GFG has provided investment advice to public and private pension funds nationwide, including a number of Atlanta-area public pension plans. Until 2011, GFG served its Georgia pension clients as a pension consultant, (although its written agreements allowed GFG to exercise discretion), advising on the selection of investments and investment

[1] A GFG affiliate is also an LP with a $1 million investment.

managers in return for a set fee. Indeed, GFG touted its supposed impartiality as a consultant by stating in many presentations: "Gray & Company's only source of revenue is from direct-fee services." Whether that was ever true, it would not be true for long come 2011.

B. A Change in Georgia Law Opens Up Possibility of Sales to GFG's Pension Consulting Clients

In July 1, 2012, a new statute ("the Georgia Investment Act"), Official Code of Georgia Annotated § 47-20-87, went into effect allowing, for the first time, investment by most large Georgia pension plans in alternative investments. The statute set out strict limitations for such investments, including that eligible pension plans could not invest in a fund that did not have at least four other unaffiliated investors invested or committed at the time of the pension fund's investment, that they could not invest in any fund with less than $100 million in assets invested or committed at the time of the pension fund investment, and that any investment by an eligible Georgia pension fund could not make up more than 20 percent of the total assets of the alternative investment fund.

C. Gray Creates an Alternative Fund and Sells It to Georgia Pension Clients in Violation of Georgia Law

Beginning in early to mid-2012, GFG, Gray, and Hubbard conceived and created GrayCo Alternative Partners II ("GrayCo Alt II" or "GrayCo Fund"), an alternative investments-based fund of funds, to take advantage of the new Georgia Investment Act. Gray was largely responsible for marketing the fund to public pension clients. As COO, Hubbard orchestrated the drafting of the offering and subscription documents, provided the investment documents containing proposed investors' names to Gray, and tracked the date and amount of the ultimate investments in GrayCo Alt II.

The Division expects to prove that both Gray and Hubbard were not only aware of the existence of the Georgia Investment Act, but were also aware of the limits on alternative investments present in the statute. Both Gray and Hubbard read the law and discussed its restrictions several times. Indeed, in an August 17, 2012 Response to a Request for Proposal for the Georgia Firefighters' Pension Fund, Gray touted his "discussions alongside Georgia's governing officials regarding . . . Georgia public fund investments since 1998" and his contribution of "numerous research articles to the new alternative investment legislation."

Approximately three weeks before the Georgia Investment Act's July 1, 2012 effective date, in a June 8, 2012 email, Hubbard forwarded the statute to Seward & Kissel LLP ("Seward"), then – GFG's outside legal counsel hired to draft the GrayCo Alt II offering documents. In the email, Hubbard referred to the Georgia Investment Act and referenced the specific lines containing the $100 million requirement. Hubbard indicated that there was "one section that we cannot seem to interpret" and requested Seward to "take a very brief look" and provide an interpretation of the $100 million requirement of the Georgia Investment Act. In making his request, Hubbard offered possible interpretations, including that $100 million needs to be committed (presumably to the issuer/investment fund) prior to a Georgia public pension committing to invest. Gray was aware of that email at the time. Approximately two hours later, Seward responded that its understanding of this restriction was that "an eligible large retirement system may only make an alternative investment in a fund that has at least $100 million in assets, including committed capital" but added that it was unclear "whether the $100M can include the [retirement] system's investment or whether the fund must have $100M prior to (i.e., excluding) the system's investment."

After receiving that advice but before finalizing the private placement memorandum, limited partnership agreement, and subscription agreement needed to market and sell GrayCo Alt II, the Respondents switched law firms, but decided to keep the fact a secret from Seward. The

Respondents instructed Seward to send them the current drafts of the offering documents and ceased requesting advice from Seward. Seward, in a response email, inquired what the Respondents intended to do about the $100 million issue. Hubbard responded that they would get a local opinion.

Gray was aware of the restrictions and saw Hubbard's June 2012 email to legal counsel, but we expect he will claim that he was confused as to the statute's exact meaning, and that he does not recall seeing Seward's response or being made aware of it. However, in an October 22, 2012 email to Hubbard and others, Gray announced initial investments in GrayCo Alt II and – evidencing his knowledge of the $100 million requirement – stated that he "would like to wrap this $100M(illion) up quickly." Respondents continue to defend by claiming that they reasonably relied on the advice of Seward regarding the Georgia Investment Act, disregarding Seward's clear communication that a fund needed to have $100 million in assets in order to be eligible for investment by Georgia public pension funds. Respondents did not ask Seward to interpret the Georgia Investment Act's other requirements, referenced above.

We expect that Gray will claim that he construed the sending of the drafts by Seward as constituting Seward's agreement with some unstated interpretation of the Georgia statute. In fact, Seward's interpretation was provided to Respondents, as stated above, and appears to have prompted Respondents to change lawyers. More than a month before the first sale of GrayCo Alt II, Hubbard wrote a subordinate saying, "Don't let them (Seward) know that we're changing counsel going forward …." Having gotten a clear message from Seward in July 2012 that "$100 million" really meant "$100 million," GFG went looking for another law firm. By August 2012, GFG had hired Greenberg Traurig, which prepared the documents that would be offered to investors and prospective investors in GrayCo Alt II.[2]

D. Gray Tells Clients, Falsely, That Investments In His Fund Are Allowed Under Georgia Law

By no later than July 2012 and throughout the fall of 2012, GFG and Gray began to recommend GrayCo Alt II to their Georgia-based public pension clients. Typically, Gray would reach out individually to the Chair and other Board members of these clients, and informally pitch alternative investments and GrayCo Alt II. Ultimately, at their respective formal Board meetings, Gray recommended that Atlanta General Pension and MARTA/ATU Retirement invest in GrayCo Alt II and recommended that the Boards of Atlanta Firefighters' Pension and Atlanta Police Pension authorize their Chairs to execute the necessary paperwork for the alternative investments.

GFG's Georgia-based public pension clients, following Gray's advice, invested in GrayCo Alt II as follows (table includes initial required investment of the general partner, a GFG affiliate):

[2] Respondents' assertion of reliance on Seward is problematic for several reasons. First, it is contradicted by the facts, since the only advice given by Seward was contrary to the Respondents' actions. Second, when Seward asked Respondents whether they had determined how to address the $100 million requirement, Respondents responded that they were "seeking an opinion locally." Third, although Respondents have not formally waived the attorney client privilege for advice given by the Greenberg firm, which represented Respondents from August 2012 through August 2013, when the last sale occurred (and still represents them), their reliance on counsel defense with regard to the topic may have effectively waived the privilege as to any such advice. *See e.g., Beck Sys. v. Managesoft Corp.*, 2006 U.S. Dist. LEXIS 53963, *citing, In re Echostar Communications Corp*, 448 F.3d 1294, 2006 WL 1149528 (Fed. Cir. 2006). The Division will address that issue separately. In any event, Respondents' approach here, asserting reliance on counsel while not waiving privilege as to advice on the topic from other lawyers, is a basis to question the good faith nature of their reliance.

Investor	Investment Date	Amount	Investor's Percentage of Total Fund Assets
Atlanta Firefighters Pension	10/20/2012	$15 million	19.2%
Atlanta Police Pension	10/22/2012	$21 million	26.9%
Atlanta General Pension	11/7/2012	$28 million	35.9%
MARTA/ATU Retirement	11/30/2012	$13 million	16.7%
General Partner (Gray Financial affiliate)		$1 million	1.3%
Total		**$78 million**	

However, by recommending and selling these investments, GFG and Gray breached their fiduciary duty to their advisory clients. The investments were unsuitable for the Georgia-based public pension clients because, as sold, the investments were illegal in that they violated the Georgia Investment Act. Specifically, GrayCo Alt. II never met the $100 million requirement at the time of the investment of any of GFG's Georgia-based public pension clients, or at any subsequent time. Indeed, the fund only raised $78 million initially, and $83 million in total. In addition, two of the Georgia-based public pension clients invested an amount greater than 20 percent of the capital invested in GrayCo Alt. II. Both the Atlanta Police Pension (26.9 percent) and the Atlanta General Pension (35.9 percent) investments exceeded the 20 percent statutory ceiling of investment in GrayCo Alt. II (based upon the initial investment of $78 million). Finally, as detailed in the table above, each of the four Georgia-based public pension clients' investments, even if considered concurrent, would violate the statutory requirement that four non-issuer affiliated investors exist prior to an investment by a Georgia public pension.

During the summer of 2013, an Atlanta newspaper raised questions concerning the propriety of the investments and the apparent lack of compliance with Georgia law. Gray again misinformed his advisory clients that the investments complied with the law.

In August 2013, after the initial close of the fund, and still far short of $100 million, the Respondents pitched MARTA/ATU Retirement to add to its commitment. MARTA/ATU Retirement did so. With its additional $5 million investment, MARTA/ATU Retirement's combined $18 million investment in GrayCo Alt II amounted to 21.7 percent of the $83 million total investment in GrayCo Alt II, which also exceeded the 20 percent statutory ceiling. (The additional MARTA/ATU Retirement investment slightly reduced Atlanta Police Pension's percentage of the total investment in GrayCo Alt II to 25.3 percent and Atlanta General Pension's to 33.7 percent). This later conduct is significant given the Respondents' position that they only relied on Seward's advice on this issue until January 2013. What about afterward?

E. Gray Continues Misrepresentations When Questioned About Compliance With the Law Both Before and After the Sales

In connection with recommending and selling unsuitable investments in GrayCo Alt II, GFG and Gray made two specific material misrepresentations to the Board of Trustees of the Atlanta General Pension on November 7, 2012. Audio recordings evidence Gray made the misrepresentations in response to questions asked by trustees prior to and during the Board's vote to invest in GrayCo Alt II.

First, when asked by an Atlanta General Pension trustee prior to voting if the proposed $28 million alternative investment that GFG was recommending was "consistent with the law," Gray responded that it "absolutely" was and that "the only reason you can do this now is because of the change in the law." Gray had no reasonable basis to make such a claim as the three relevant limitations of the Georgia Investment Act, discussed above, were not met at that time:

(a) Atlanta General Pension's $28 million investment was and still is greater than 20 percent of the capital invested in GrayCo Alt II (Gray and Hubbard testified that the goal for GrayCo Alt II, as indicated by the "cover" amount on the private offering memorandum, was to raise $100 million in capital commitments); (b) four other investors not affiliated with GFG had not previously been invested or concurrently invested or committed to invest; and (c) GrayCo Alt II did not have at least $100 million in assets, including committed capital, at the time Atlanta General Pension's investment was initially made or committed to be made.

Second, Gray falsely stated that certain other public pension clients had already invested in GrayCo Alt II. Prior to the conclusion of the November 7, 2012 meeting, a vote was called on whether to authorize a $28 million investment in GrayCo Alt II. During the course of the vote, a trustee asked Gray who else had invested in the fund. In response, Gray referenced, among a few others, four pension plans, three of which never invested in the fund and one of which did not invest until three weeks later. Specifically, in response to the trustee questions, Gray stated that "MARTA is already done" and that "Michigan, New York, Chicago, those plans are already executed as well." Gray had no reasonable basis to claim that MARTA/ATU Retirement was done because its Board did not even vote to invest or execute its subscription agreement until November 30, 2012, more than three weeks after Atlanta General Pension's investment. Moreover, the statement that Michigan, New York, and Chicago plans were executed was absolutely false.

III. LEGAL ANALYSIS

A. Gray Financial and Gray Violated Advisers Act Sections 206(1) and 206(2) and Hubbard Aided, Abetted and Caused Their Violations

Section 206(1) of the Advisers Act makes it unlawful for an investment adviser to employ any device, scheme or artifice to defraud any client or prospective client. Section 206(2) makes it unlawful for an investment adviser to engage in any transaction, practice or course of business that operates as a fraud or deceit upon any client or prospective client. Under Sections 206(1) and 206(2), an investment adviser owes a fiduciary duty to its clients. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963). These duties include the duty to act for the benefit of clients, the duty to exercise the utmost good faith in dealing with clients, the duty to disclose all material facts, and the duty to employ reasonable care to avoid misleading clients. *See id.* at 194. Furthermore, investment advisers owe their clients a duty to provide only suitable investment advice. *See In re Philip A. Lehman*, Advisers Act Rel. No. 1896 (Sept. 7, 2000) (Settled Order) (adviser recommended risky investment for customer's individual retirement account, despite customer's conservative investment objective and age). *See also* Division of Investment Management's *Regulation of Investment Advisers* at 24 (March 2013) (Note 134, *citing Suitability of Investment Advice Provided by Investment Advisers,* Investment Advisers Act Rel. No. 1406 (Mar. 16, 1994)).

Information is material if "there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Basic v. Levinson*, 485 U.S. 224, 231 (1988). To fulfill the materiality requirement, there must be a substantial likelihood that a fact "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." 485 U.S. at 231-32. The legality of the investment would clearly have been material in this instance.

Scienter is an element of a Section 206(1) violation. *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979), *aff'd*, 450 U.S. 91, *reh'g denied,* 451 U.S. 933 (1981). Scienter is defined as "knowing or reckless conduct." *SEC v. Steadman*, 967 F.2d 636 (D.C. Cir. 1992) (recklessness is sufficient to establish scienter). A violation of Section 206(2) does not require proof of scienter. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92 (1963).

GFG and Gray breached their fiduciary duty to their Georgia pension fund clients in violation of Sections 206(1) and (2) of the Advisers Act by providing them with unsuitable investment advice to invest in GrayCo Alt. II in violation of state law.[3] GFG and Gray acted with scienter. They offered and sold GrayCo Alt. II to their Georgia public pension clients despite being aware or reckless in not knowing that these investments violated certain requirements of the Georgia Investment Act. While GFG and Gray claim that they had a lack of intent because they reasonably relied on the advice of their former legal counsel, Seward, regarding the Georgia Investment Act, they ignored Seward's specific advice that GrayCo Alt. II needed $100 million in assets to be suitable for Georgia based public pension plans, and promptly changed law firms after receiving that advice. Greenberg Traurig, not Seward, prepared the final solicitation and sale documents and represented GFG regarding GrayCo Alt II at the time of each and every unsuitable sale. Yet Respondents do not appear to have asserted any reliance on the advice of Greenberg, suggesting that they never received advice from that firm on the relevant issues.

The motive here was largely financial. GFG, through its affiliates, would receive substantial compensation if the fund got off the ground. That compensation was one percent of moneys invested (which were committed for ten years). In this case one percent of $80 million

[3] The Court should find that Gray qualifies as an investment adviser and thus directly violated the Advisers Act. The Commission has previously found that "an associated person is liable under Section 206 where the investment adviser is an alter ego of the associated person or is controlled by the associated person." *See John J. Kenny*, 56 S.E.C. 448, 485 n.54 (2003); *But see, Alexander V. Stein*, 52 S.E.C. 296, 299 & n.10 (1995); *See also Anthony Fields, CPA*, Securities Act Rel. No. 9727, 2015 SEC LEXIS 662 at *60-61 (Feb. 20, 2015) (Commission Opinion) (holding that Fields's activities a president, chief compliance officer, and control person of an investment adviser bring him within the "broad" definition of investment adviser under the Advisers Act). GFG is the alter ego of Gray who has been its President since founding it, has served as its CEO until July 2013, and is 75 percent or more owner of GFG. Gray can be charged with direct violations of Sections 206(1) and (2) of the Advisers Act because he recommended investments to clients who paid GFG advisory fees which flowed to Gray.

was $800,000 per year. In addition, GFG would receive 10 percent of any gains over eight percent. According to Gray, the target return was 20 percent. That works out to another $96,000 per year. Such compensation was significantly more than what Respondents would have received had they invested the Georgia pension funds in another investment.

The potential fees were extremely material to GFG and Gray. A GFG balance sheet as of December 2012 shows stockholders equity of **negative** $807,000. Having failed to make certain tax payments in prior years, Gray was at odds with the Internal Revenue Service ("IRS"), which had a lien on his home. A settlement with the IRS required GFG to pay $8,000 per month on an obligation of more than $500,000, but that settlement did not resolve all issues. The IRS was pursuing Gray for additional amounts as well, possibly adding another $350,000 to his obligation to the IRS.

Gray also settled a claim by a former client (Clark) in March 2012 for $1 million with a strict payment plan which required Gray to make payments of $250,000 on March 29, 2012, $125,000 on July 1, 2012, $125,000 on December 31, 2012, $150,000 on July 1, 2013, and beyond, with the unpaid balance of the $1 million settlement bearing interest of 6.25 percent per year. Over and above the settlement amount, Gray owed his attorneys more than $500,000 for defending him in the lawsuit.

GFG and Gray acted with scienter in making material misrepresentations on November 7, 2012 to the Board of Atlanta General Employee's Pension Fund. The misrepresentations were material because they were in response to trustees' questions and made before and during the Boards' vote to invest in GrayCo Alt. II. The legality of an investment is of obvious importance to the reasonable investor and is material. Finally, whether other large, possibly more sophisticated and well-funded public pensions invested in an investment is also material.

Gray acted with scienter by at least recklessly responding that the investment was "absolutely" consistent with the law as the plain reading of the three relevant limitations of the Georgia Investment Act were not met at that time. Atlanta General Pension's $28 million investment was, and remains greater than 20 percent of the capital to be invested in GrayCo Alt. II. Four other investors not affiliated with GFG had not previously been invested or concurrently invested or committed to invest. GrayCo Alt. II did not have at least $100 million in assets, including committed capital, at the time Atlanta General Pension's investment was initially made or committed to be made. Gray was also at least reckless to claim on November 7, 2012 that MARTA/ATU Retirement was "already done" because MARTA/ATU Retirement's Board did not even vote to invest or execute its subscription agreement until November 30, 2012. Finally, there were never any investors in GrayCo Alt. II from Michigan, New York, or Chicago, as Gray claimed during the Board meeting.

Hubbard aided, abetted and caused GFG and Gray's violations of Sections 206(1) and (2). To establish aiding and abetting liability, the Commission must find: (1) a primary violation of the securities laws by a third party; (2) the respondent substantially assisted in the violations; and (3) the respondent provided that assistance with the requisite scienter—knowing of, or recklessly disregarding, the wrongdoing and his role in furthering it. *In re VanCook*, Rel. No. 34-61039A (Nov. 20, 2009) (Opinion of the Commission). A respondent who aids and abets a violation also is a cause of the violation under the federal securities laws. *See Sharon M. Graham*, 53 S.E.C. 1072, 1085 n.35 (1998), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000). In administrative proceedings, the Commission applies a "recklessness" standard for aiding and abetting liability. *See, In re vFinance Investments, Inc.*, Exchange Act Rel. No. 62448, 2010 SEC LEXIS 2216, *46 (July 2, 2010) (Commission Opinion). The element of substantial assistance is met when the defendant "in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed." *SEC v. Apuzzo*, 689 F.3d 204, 212 (2d Cir. 2012).

Hubbard, through his email communications, was aware of Seward's understanding that GrayCo Alt. II needed to have $100 million in assets, including committed capital in order for eligible Georgia large retirement systems to make investments. He nevertheless substantially assisted in offering and selling investments in GrayCo Alt. II to GFG's pension consulting clients by supplying the offering documents containing the public pension funds' names on them to Gray and collecting the executed documents, including the Atlanta Police Pension's documents, in which Hubbard assisted in obtaining the signature of its Board's Chairman.[4]

Upon receipt of the subscription agreements, it was or should have been clear to Hubbard that GrayCo Alt II failed to raise $100 million. Hubbard's claim that he lacked intent because he reasonably relied on the advice of Seward regarding the Georgia Investment Act, like the claims of GFG and Gray, is also unpersuasive as he clearly failed to meet the basic requirements of such a defense. Hubbard knew that Seward had actually given contrary advice, and knew that GFG was no longer relying on Seward's legal advice. He instructed GFG personnel to hide the fact from Seward.

B. The Respondents Violated Securities Act Sections 17(a)(1) and (3), and Exchange Act Section 10(b) and Rules 10b-5(a) and (c) thereunder. Hubbard also Aided Abetted, and Caused Gray Financial and Gray's Violations);

Section 17(a)(1) prohibits "employ[ing] any device, scheme or artifice to defraud," and Section 17(a)(3) bars "engag[ing] in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser" in the offer or sale of

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[4] Hubbard's substantial involvement in selling the investments in GrayCo Alt. II is also demonstrated by his signature on behalf of GFG on the subscription agreement of one of the two Georgia-based public pensions who effectively rescinded their investments in November 2012.

securities. Similarly, Rule 10b-5(a) prohibits "employ[ing] any device, scheme or artifice to defraud," and Rule 10b-5(c) bars "engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of securities. Establishing a violation of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder requires a showing of scienter, while violations of Section 17(a)(3) can be established by showing negligence. *Aaron v. SEC*, 446 U.S. 680, 701-02 (1980). Primary liability under Rule 10b-5(a) and (c) extends to anyone who employs any manipulative or deceptive device or engages in any manipulative or deceptive act. Primary liability under those sections also encompasses the "making" of a fraudulent misstatement to investors, as well as the drafting or devising of such a misstatement. By contrast, Section 17(a) does not require conduct that is itself manipulative or deceptive; however, there must be a showing that investors were or could have been defrauded by the conduct. Like Rule 10b-5(a) and (c), 17(a)(1) encompasses all scienter-based, misstatement-related conduct. 17(a)(3) encompasses misstatements to the extent they can be deemed fraudulent transactions, practices or courses of business. As explained above, the different subsections of 17(a) and Rule 10b-5 are not mutually exclusive. *See In re Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961)(stating that the individual subsections of 10b-5 "are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others").

As described above, GFG, Gray, and Hubbard acted with scienter when they engaged in a scheme to defraud their Georgia public pension fund consulting clients by recommending, offering, and selling GrayCo Alt II (a pooled investment), notwithstanding that they knew or recklessly failed to note that the investments violated Georgia law.

Hubbard aided, abetted and caused GFG and Gray's violations of the above provisions. As discussed above, Hubbard was aware of the requirements of the Georgia Investments Act and of Seward's advice regarding that Act, and he nevertheless substantially participated in offering and selling investments in GrayCo Alt II to GFG's pension consulting clients.

C. Gray and Gray Financial Violated Securities Act Section 17(a)(2), Exchange Act Section 10(b) and Rule 10b-5(b) thereunder, and Advisers Act Section 206(4) and Rule 206(4)-8(a)(1) thereunder

A violation of Section 10(b) of the Exchange Act, and Rule 10b-5(b) thereunder may be established by showing (1) a material misrepresentation or materially misleading omission, (2) made in connection with the purchase or sale of securities, (3) with scienter. *Aaron*, 446 U.S. at 695-97; *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 766 (11th Cir. 2007). Courts construe broadly the requirement that the violative activity occur in connection with the purchase or sale of a security. *SEC v. Zandford*, 535 U.S. 813, 819 (2002). A violation of Section 17(a)(2) of the Securities Act may be established by showing that the defendant (1) obtained money or property by means of (2) any material misrepresentation or materially misleading omission of fact (3) in the offer or sale of a security. Establishing a violation of Section 17(a)(2) can be established by showing negligence. *Aaron*, 446 U.S. at 701-02.

To prove violations based on misrepresentations or omissions under both Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5, the Commission must show that the misrepresentations or omissions were material. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom.*, 394 U.S. 976 (1969), *reh'g denied*, 404 U.S. 1064 (1972). Section 17(a)(1), Section 10(b) and Rule 10b-5 require a showing of scienter. Scienter may be established through a heightened showing of recklessness. Proof of scienter may be "a matter of inference from circumstantial evidence." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983). The scienter requirement may be met by a corporation, as the mental state of an officer acting on a corporate issuer's behalf may be imputed to the corporation. *See SEC v. Manor Nursing Centers*, 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972).

GFG and Gray violated Section 17(a)(2) of Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder, and Section 206(4) of the Advisers Act and Rule 206(4)-8(a)(1) thereunder by making material misrepresentations to the Atlanta General Employees' Pension Board that investing in GrayCo Alt. II was "absolutely" consistent with Georgia law and that MARTA/ATU Retirement was "already done" and that "Michigan, New York, Chicago" had "already executed" their investments in GrayCo Alt. II. As discussed above, the misrepresentations were material as they were made in response to trustees' questions before and during their decision on voting to invest pension assets in GrayCo Alt. II, and related to the material legality of the investment and the identities of other large and possible more sophisticated investors.

Gray acted with scienter and was at least reckless in making these misrepresentations because MARTA/ATU Retirement had not even voted to invest in GrayCo Alt. II (and Gray was present at the meeting three weeks later when they did vote to invest) and Michigan, New York, Chicago have never executed documents to invest in GrayCo Alt. II. In addition, Gray should have known that his statements were untrue.

In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the Supreme Court limited the persons who may be held primarily liable for "making" a misleading statement under Section 10(b) and Rule 10b-5(b). Under *Janus,* for Rule 10b-5(b) purposes; "the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id.* at 2302. The Court observed that "[o]ne 'makes' a statement by stating it," and emphasized the importance of "attribution" in determining who has "ultimate authority" and is thus the "maker" of a statement. Gray, and through Gray, GFG, each were the "makers" of the statements. Gray, President, 75 percent or more owner of GFG, and at the time, CEO of GFG, made the oral statements (captured in the audio recording) to the Atlanta General Employees' Pension Board members before and during their vote to invest pension assets in GrayCo Alt. II. Gray's statements are imputed to GFG.

Section 206(4) of the Advisers Act prohibits an investment adviser from, directly or indirectly, engaging in any act, practice or course of business which is fraudulent, deceptive, or manipulative. Rule 206(4)-8 defines such prohibited conduct to include making false or misleading statements or otherwise engaging in fraudulent acts or practices to defraud investors or prospective investors in pooled investment vehicles. Section 206(4) and Rule 206(4)-8(a)(1) also require a showing that the misstatements or omissions are material. Violations of Section 206(4) and Rule 206(4)-8 thereunder do not require proof of scienter. *See, SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir.1992). *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles,* SEC Rel. No. 33-8766, IA-2628 (Aug. 3, 2007). Gray and GFG also violated these provisions by their conduct and Hubbard aided and abetted and caused those violations.

IV. RELIEF REQUESTED

A. Cease-and-Desist Order and Associational Bars are Appropriate

Section 203(e) of the Advisers Act authorizes the Commission to sanction any investment adviser if it is in the public interest and the Commission finds that the adviser has willfully violated any provision of the federal securities laws. Section 203(f) of the Advisers Act authorizes the Commission to sanction any person associated with an investment adviser under the same circumstances. Section 9(b) of the Investment Company Act authorizes the Commission to sanction any person under the same circumstances. Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act authorize the Commission to enter a cease-and-desist order against any person who has committed or caused a violation of these statutes, respectively. Based on the violations noted above, this Court should impose cease-and-desist orders against Gray, Hubbard, and GFG. In addition, this Court should bar Gray and Hubbard from the securities industry and revoke GFG's registration.

B. Civil Penalties and Disgorgement and Prejudgment Interest

Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act allow the Commission to impose civil penalties in proceedings instituted pursuant to Section 21C of the Exchange Act, Sections 203(e), (f), and (k) of the Advisers Act, and Section 9(b) of the Investment Company Act, respectively. The Commission also may impose civil penalties in cease-and-desist proceedings pursuant to Section 8A of the Securities Act. The Division asks the Court to determine whether civil penalties are appropriate against the Respondents.

Section 21B(e) of the Exchange Act, Sections 203(j) and 203(k)(5) of the Advisers

Act and Section 9(e) of the Investment Company Act allow the Commission to impose disgorgement, including prejudgment interest, in administrative proceedings. The Commission also may impose disgorgement and prejudgment interest in cease-and-desist proceedings pursuant to Section 8A of the Securities Act and Section 21C(e) of the Exchange Act. The Division has subpoenaed from Respondents the records necessary to show the amounts by which they have been enriched by the above-described misconduct. The Division will ask for an order of disgorgement and prejudgment.

V. CONCLUSION

The Division stands ready to brief any additional legal or evidentiary issues that the Court would like to have addressed.

Respectfully submitted this 23rd day of January, 2017.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that he has served a copy of the DIVISION'S PRE-HEARING BRIEF, by electronic mail and by United Parcel Service, addressed as follows:

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This 23rd day of January, 2017.

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