



ADMINISTRATIVE PROCEEDING  
FILE NO. 3-17003

**UNITED STATES OF AMERICA**  
**before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**In the Matter of**

**PETER J. EICHLER, JR.,**

**Respondent.**

**Judge Carol Fox Foelak**

**DIVISION OF ENFORCEMENT'S**  
**MOTION FOR SUMMARY DISPOSITION**

February 12, 2016

Division of Enforcement  
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## **I. INTRODUCTION**

The Division of Enforcement (“Division”) moves, in accordance with Rule 250 of the Commission’s Rules of Practice and the Court’s January 29, 2016 Prehearing Order, for summary disposition in this follow-on administrative proceeding. On December 14, 2015, the Division instituted this proceeding against Respondent Peter J. Eichler, Jr. under Section 15(b) of the Securities Exchange Act (“Exchange Act”) and Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”). In a district court enforcement action brought against him in 2012, Eichler ultimately consented to the entry of a permanent injunction, and agreed that he could not deny any of the allegations in the Commission’s complaint in connection with this proceeding. Based on this injunction, as well as the facts detailing his fraudulent “cherry-picking” scheme that he cannot dispute, the Division now requests that Eichler be permanently barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization.

Until December 2012, when his asset management firm filed for bankruptcy, Eichler was the chairman, chief executive officer, and chief investment officer of a registered investment adviser called, Aletheia Research and Management, Inc. (“Aletheia”). Eichler’s underlying fraud was a “cherry-picking” scheme, in which he, as an investment adviser, waited – for hours and sometimes days after execution – to allocate trades to certain client and personal trading accounts. By waiting to allocate these trades, Eichler was able to identify winning and losing trades in light of post-trade movements in the market. With that improper knowledge, he was able to then allocate winning trades to his favored accounts and clients (including his own), and losing trades to disfavored accounts and clients.

Eichler was personally responsible for each and every investment decision made by Aletheia during the relevant period. And Eichler abused that discretion for his own advantage.

Over a 27-month period in which he placed thousands of option trades, Eichler saddled two disfavored hedge funds – investment vehicles that he no longer had any incentive to manage profitably because of widespread investor redemptions and past trading losses – with losing option trades, and he allocated to himself winning option trades. In carrying out this scheme, Eichler violated the fiduciary duties he owed to his advisory clients, and broke the law.

## II. STATEMENT OF FACTS

### A. **Procedural History**

In December 2012, the Commission sued Eichler in the United States District Court for the Central District of California in an enforcement action captioned *SEC v. Aletheia Research and Management, Inc., et al.*, Case No. CV 12-10692-JFW (RZx). The Commission’s complaint alleged that Eichler violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder; and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Declaration of Gary Y. Leung (“Leung Decl.”), Ex. 1.

On November 4, 2013, Eichler consented, on a neither admit nor deny basis, to entry of a final judgment against him in *SEC v. Aletheia*. *Id.* Ex. 2. In addition, Eichler agreed in his consent that “in any disciplinary proceeding before the SEC based on the entry of the injunction ... he shall not be permitted to contest the factual allegations of the complaint.” *Id.* at p. 5, lines 2-5.

Because Eichler’s consent was bifurcated, Eichler and the Commission litigated the issue of remedies before the district court. The Commission retained David W. Prager to analyze and express Fed. R. Evid. 702 opinions on option trading by Aletheia, including the manner in which option trades were allocated, their relative profitability for participating accounts, whether any disparate performance could be the result of differing investment mandates among accounts, and the extent to which Eichler’s fraudulent allocations benefited favored accounts and harmed

disfavored accounts.<sup>1</sup> After considering the parties' competing evidence, the district court credited Prager's analysis of Eichler's option trading, finding *inter alia* that:

When trades were late-allocated, Eichler's favored accounts performed significantly better than the disfavored Hedge Funds. In fact, the 12 option-trading accounts held by Eichler or members of Eichler's family (the "Eichler Accounts") exceeded the average of all late-allocated option trades by 8.4%, whereas the disfavored Hedge Funds performed 4.9% worse than the average.

Leung Decl., Ex. 5 at p.2 (district court ruling, Dkt. No. 71). The district judge also accepted Prager's calculation of Eichler's ill-gotten gain: "[T]he SEC has demonstrated a reasonable approximation of Eichler's ill-gotten gains in the amount of \$1,655,923, and that Eichler has failed to demonstrate that the SEC's figure was not a reasonable approximation." *Id.* at 4.

On May 11, 2015, the court entered a final judgment against Eichler, awarding the Commission monetary remedies and permanently enjoining Eichler from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. *Id.*, Ex. 3.

The Division instituted this proceeding with an Order Instituting Proceedings ("OIP") on December 14, 2015, pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act. Eichler was deemed served with the OIP on December 18, 2015. When he did not answer the OIP, the Presiding Judge issued a January 22, 2016 order finding Eichler in default and ordering him to show cause for why he should not be barred from the securities industry. On January 21, Eichler submitted a declaration averring to matters largely immaterial to the present proceeding. The declaration did not deny the material allegations of the OIP. At the January 29 prehearing conference, the Presiding Judge granted the Division leave to file the

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<sup>1</sup> Mr. Prager's expert report is attached as Exhibit 4 to the Leung Declaration.

instant Rule 250 motion for summary disposition.

**B. Eichler Engaged in a Scheme to Defraud**

The complaint in the district court action alleged Eichler's fraud in painstaking detail. Under the terms of his consent, Eichler cannot deny that he engaged in a fraudulent cherry-picking scheme over a 27-month period – during which Eichler late-allocated thousands of option trades – all with a high degree of scienter.

**1. Aletheia's investment advisory business**

Aletheia was a registered investment adviser that managed, at its peak, more than \$10 billion in client assets. Leung Decl., Ex. 1 at ¶¶ 11-12. Eichler was Aletheia's founder, chairman, chief executive officer, and chief investment officer. *See id.* at ¶¶ 10, 20. As Aletheia's CEO and CIO, Eichler had ultimate responsibility for all investment decisions made by Aletheia and discretionary authority over all client accounts. *Id.* During the period in question, he was individually responsible for all of Aletheia's investment decisions, and in particular, the fraudulent cherry-picking of option trades recounted below. *Id.*

Aletheia provided various managed investment products to its clients, including several portfolio strategies. *Id.* at ¶ 12. In addition to its portfolio products, Aletheia managed investment accounts for its individual advisory clients, certain of its officers and employees (including Eichler's own trading accounts), and two affiliated hedge funds. *See id.* at ¶ 14. The two affiliated hedge funds – the Aletheia Insider Index, L.P. and the Aletheia Insider Index II, L.P. (“Insider Hedge Funds”) – were privately-offered to Aletheia advisory clients. *See id.* at ¶ 17. Aletheia was the general partner and investment manager of the two hedge funds and consequently had sole authority to conduct their operations. *See id.* at ¶¶ 17-18.

From mid-August 2009 through November 2011 (the “relevant period”), Eichler used Aletheia's discretionary authority to engage in option trading for more than four dozen Aletheia

advisory accounts. *See id.* at ¶ 12. These option trading accounts were comprised of Aletheia’s proprietary account and accounts held by a handful of Aletheia advisory clients, certain officers and employees of Aletheia, Eichler himself, and last, the Insider Hedge Funds. *See id.* at ¶¶ 14-17.

Significantly, however, the Insider Hedge Funds’ net assets were falling precipitously during the relevant period – plummeting, at the end of 2008 through July 2012, from about \$110 million to only \$2.7 million in assets. *Id.* at ¶ 19. And because Aletheia’s management fees for the Insider Hedge Funds were tied to the value of assets under management, Eichler became far less incentivized to manage those hedge funds in a profitable way. *Id.* at ¶¶ 2, 19, 22. Eichler consequently engaged in a cherry-picking scheme which wrongly benefited favored option trading accounts – including, most notably, Eichler’s own trading account – at the expense of the Insider Hedge Funds. *Id.*

## **2. Aletheia’s Trading and Allocation Procedures Enabled Eichler to “Cherry-Pick”**

Eichler made all buy and sell decisions for the option trading accounts. *Id.* at ¶¶ 20, 22. He further exercised unilateral control over how those option trades, once executed, would then be allocated to participating accounts. *Id.*

### **a. Cherry-picking**

“Cherry-picking” is the practice of allocating winning trades to favored accounts, and conversely, allocating losing trades to disfavored accounts. *See id.* at ¶ 2. When a trade remains unallocated following trade execution, the passage of time makes that trade increasingly susceptible to cherry-picking. *See id.* at ¶ 23. That is because post-execution movements in price permit an investment adviser to make allocations decisions at a time when the trade constitutes not simply an investment opportunity, but instead a known mark-to-market profit or

loss. *Id.* The opportunity to cherry-pick an unallocated trade is most prevalent once an options position is closed – *i.e.*, bought and sold – and thus, a realized profit or loss on the trade is known with certainty. *See id.* at ¶ 23.

**b. Eichler’s pervasive late-allocation of option trades**

To effectuate his cherry-picking scheme, Eichler orally communicated block option trades to the Aletheia trading assistant responsible for executing option trades. At that time, however, Eichler would only tell her the option being traded, the quantity to be purchased, and in some cases, a price limit for the trade. *Id.* at ¶ 24. Crucially, Eichler did not tell the trading assistant, at the time of order execution, how a block trade would eventually be allocated. *Id.* As instructed by Eichler, the trading assistant then placed a block order with Aletheia’s clearing broker, National Financial Services, LLC (“NFS”), through NFS’s trading system. *Id.* at ¶ 25. But Eichler consistently waited until later in the trading day, at or near market close, to tell the trading assistant how the trade should be allocated. *Id.* at ¶¶ 27-28. Only at that later time – with the profitability of the trade now more evident – would the trading assistant access NFS’s trading system and allocate an earlier executed block option trade among participating Aletheia-managed accounts. *Id.* at ¶ 27.

In the relevant period, Eichler executed 4,938 option trades over a total of 600 trading days. Leung Decl., Ex. 4 (Prager Report) at p. 3, ¶ 9. A majority – 60.8% or 3,004 trades – of these option trades were not allocated for more than an hour after trade execution (the “late-allocated trades”). Leung Decl., Ex. 4 (Prager Report) at pp. 3-4, ¶ 9 fig. 1.

**c. “Cancelling and rebooking” of trades**

During the first year of the relevant period, Aletheia executed option trades through two different allocation accounts: an allocation account dedicated to the Insider Hedge Funds and a general allocation account for the remaining Aletheia advisory accounts. Leung Decl., Ex. 1

(Compl.) at ¶ 26. Notwithstanding this, Eichler repeatedly moved option trades both to and from the disfavored Insider Hedge Funds either by cancelling an initial trade from the general Aletheia allocation account, and then replacing that trade in the hedge funds' allocation account; or by cancelling an initial trade from the hedge funds' allocation account, and then replacing that trade in the general Aletheia allocation account. *Id.* at ¶¶ 2, 23-27. By delaying allocation for hours and sometimes days after trade execution, and also by “cancelling and rebooking” option trades, Eichler was able to cherry-pick trades for his own ill-gotten gain. *Id.* at ¶¶ 2, 23-27.

**d. “Open” and “perfect information” trades**

Further, when Eichler late-allocated many of the option trades in question, the position remained open at the time of allocation (“open trades”). But for a significant subset of late-allocated trades, Eichler waited to allocate until after he had both bought and sold the position at issue. Leung Decl., Ex. 4 (Prager Report) at p. 4, ¶ 11. In the case of those trades, Eichler was able to make allocation decisions with the benefit of perfect knowledge about the trade's guaranteed profit or loss (the “perfect information trades”). Leung Decl., Ex. 1 (Compl.) at ¶ 33; *see also* Ex. 4 (Prager Report) at p. 4, ¶ 11. Of the 3,004 late-allocated trades, 483 were perfect information trades. *Id.* As detailed below, Eichler's allocation of these perfect information trades was likewise marred by rampant cherry-picking.

**3. Eichler Disproportionately Allocated Profitable Trades to Himself**

Over the course of thousands of option trades in the relevant period, Eichler cherry-picked option trades for his own benefit, and to the detriment of the Insider Hedge Funds. Leung Decl., Ex. 1 (Compl.) at ¶¶ 2, 29-39. A statistical comparison of the investment returns on late-allocated trades bears this out in full. The Commission's expert determined that late-allocated trades were far more profitable for Eichler and far less profitable for the disfavored hedge funds; that Eichler's timely-allocated trades (which he could not cherry-pick) unaccountably fared far

worse than his late-allocated trades (which he did cherry-pick); and that this disparate performance was statistically significant – it could not have been the product of random chance. *See* Leung Decl., Ex. 4 (Prager Report) at p. 13, ¶ 27-30, 34-37, 40, 43.

Most telling was the disparate performance for the subset of late-allocated trades that were perfect information trades. In the case of those 483 trades, Eichler knew with absolute certainty how the trade had turned out. What he allocated, then, was not an economic opportunity, but instead the equivalent of a cash gain or loss. Eichler's personal trading account outperformed the disfavored hedge funds' account by an inexplicable margin. 91.3% of all perfect information trades were profitable. Despite this, only 41.4% of the perfect information trades that the Insider Hedge Funds received were profitable. Unsurprisingly, Eichler's personal trading account did appreciably better. Virtually all (98.5%) of the perfect information trades that Eichler allocated to himself were profitable. Leung Decl., Ex. 4 (Prager Report) at p. 14, ¶ 40 fig. 9.

This disparate performance is especially egregious given the amount of capital invested by the hedge funds relative to the capital invested by Eichler and other favored accounts. Despite accounting for 77% of the capital invested in perfect information trades, the disfavored hedge funds took no share of the aggregate profits from those trades. *Id.* at p. 15, ¶ 43 fig. 10. In total, the disfavored hedge funds in fact *lost* money on their perfect information trades. *Id.* For his part, Eichler's personal trading was responsible for only 9.6% of the total capital invested on perfect information trades. Yet he took nearly *half* of all trading profits from the 483 perfect information trades, for an illicit gain of \$1,068,638. *Id.* Because the favored accounts took all of the trading profits on perfect information trades and more, the corresponding losses sustained by the Insider Hedge Funds paid, in substance, for the favored accounts to make money.



#### **4. Eichler Acted With Scienter**

Eichler cannot dispute that he acted with scienter when perpetrating his cherry-picking scheme. Leung Decl., Ex. 1 (Compl.) at ¶ 49. As alleged in the complaint:

[Eichler] acted with scienter in perpetrating the cherry-picking scheme ...  
[T]here is no doubt that [Eichler]: knowingly or recklessly intended to deceive, manipulate or defraud advisory clients of Aletheia through a device, scheme, or artifice to defraud[.]

*Id.* In sum, Eichler personally made each and every allocation decision in issue. *Id.* And over a more than two-year period, Eichler knowingly or recklessly late-allocated *thousands* of option trades in a manner that disproportionately benefited favored client accounts – including, principally, Eichler’s own account. *Id.* In doing so, he knowingly or recklessly intended to deceive, manipulate, or defraud the disfavored hedge funds, who were also his advisory clients, in breach of his fiduciary duties. *Id.*

#### **5. Eichler’s Illegal Profits**

In the district court action, the trial judge found that \$1,655,923 is a reasonable approximation of Eichler’s ill-gotten profits from his cherry-picking scheme. Leung Decl., Ex. 5 at pp. 3-4 (district court ruling, Dkt. No. 71). Taking into account the returns that they would have obtained but for Eichler’s scheme, Prager determined that the disfavored hedge funds suffered incremental losses of at least \$2.3 million. Leung Decl., Ex. 4 (Prager Report) at pp. 10-11, ¶¶ 31-32.

### **III. ARGUMENT**

#### **A. Summary Disposition is Appropriate in this Proceeding**

Rule 250 of the Commission’s Rules of Practice, 17 C.F.R. § 201.250, provides that after a respondent’s answer has been filed and documents have been made available to the respondent for inspection and copying, a party may move for summary disposition of any or all allegations

of the OIP. A hearing officer may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law. Rule of Practice 250(b).

Summary disposition is particularly appropriate here because the facts have been litigated in an earlier judicial proceeding, an injunction was entered by the district court, and the sole remaining determination concerns the appropriate sanction. *See, e.g. Omar Ali Rizvi*, Initial Dec. Rel. No. 479 (Jan. 7, 2013), 105 S.E.C. Docket 1529, 2013 WL 64626 (“Commission has repeatedly upheld use of summary disposition in cases where the respondent has been enjoined and the sole determination concerns the appropriate sanction.”), *notice of finality*, Release No. 69019 (Mar. 1, 2013), 105 S.E.C. Docket 3126, 2013 WL 772514; *Daniel E. Charboneau*, Initial Dec. Rel. No. 276 (Feb. 28, 2005), 84 S.E.C. Docket 3476, 2005 WL 474236 (summary disposition granted and penny stock bar issued based on injunctions and memorandum opinion issued by trial court on Commission complaint), *notice of finality*, 85 S.E.C. 157, 2005 WL 701205 (Mar. 25, 2005); *Currency Trading Int’l Inc.*, Initial Dec. Rel. No. 263 (Oct. 12, 2004), 83 S.E.C. Docket 3008, 2004 WL 2297418 (summary disposition granted and broker-dealer bar issued based on trial court’s entry of injunctions and findings of fact and conclusions of law), *notice of finality*, 84 S.E.C. Docket 440, 2004 WL 2624637 (Nov. 18, 2004).

Moreover, as part of his consent to the entry of permanent injunctions against him, Eichler agreed that he cannot “contest the factual allegations of the complaint” in this proceeding. Leung Decl. Ex. 2, p. 5, lines 2-5. The Commission’s district court complaint alleged that for more than two years, and acting with a high level of scienter, Eichler engaged in a fraudulent scheme to cherry-pick option trades in breach of his fiduciary duty to his clients. *Id.*, Ex. 1. For purposes of this proceeding, the allegations in the complaint cannot be disputed.

## **B. Eichler Should Be Barred from the Securities Industry**

Based on the facts that Eichler cannot deny, the sole sanction the Division seeks here – a permanent bar from the securities industry – is well justified. Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act, as amended by Section 925(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 925(b), 124 Stat. 1376 (2010) [codified at 15 U.S.C. § 80b-3(f)] (“Dodd-Frank”), provide that the Commission may bar a person from being associated with a “broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization,” if the Commission finds, on the record after notice and opportunity for a hearing, that such a bar “is in the public interest” and that the person is enjoined from certain violations of the federal securities laws, including, for the purposes of this proceeding, violations of the antifraud provisions. *See* 15 U.S.C. § 78o(b); 15 U.S.C. § 80b-3(f). Accordingly, to prevail on this proceeding, the Division must establish that: (i) Eichler has been enjoined from violating the federal securities laws; and (ii) it is in the public interest to impose a bar against him.

The first requirement of this test is easily satisfied. On May 15, 2015, the district court entered an order and final judgment against Eichler in the case, *SEC v. Aletheia Research and Management, Inc., et al.*, permanently enjoining him from violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Leung Decl., Ex. 3. Eichler does not dispute the entry of these injunctions.

The second requirement – that the bar is in the public interest – is likewise met. As described at length below, the undisputed factual allegations in the underlying district court action demonstrate that a bar is warranted and in the public interest to prevent a recurrence of

Eichler's unlawful conduct. Whether an administrative sanction based upon an injunction is in the public interest turns on 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, recognition of the wrongful conduct, and the likelihood that the respondent's occupation will present future opportunities for violations. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *In re Vladimir Boris Bugarski*, No. 3-14496, 2012 WL 1377357, at \*4 (Commission Op. April 20, 2012). "The existence of an injunction can, in the first instance, indicate the appropriateness in the public interest of a suspension or bar from participation in the securities industry." *Michael V. Lipkin and Joshua Shainberg*, Initial Dec. Rel. No. 317 (Aug. 21, 2006), 88 S.E.C. Docket 2346, 2006 WL 2422652 \*4. The Commission also considers whether the sanction will have a deterrent effect. *Id.* "[N]o one factor is dispositive." *In re Michael C. Pattison, CPA*, No. 3-14323, 2012 WL 4320146, at \*8 (Commission Op. Sept. 20, 2012); *ZPR*, 2015 WL 6575683, at \*27 (inquiry into the public interest is "flexible").

Here, all of these considerations weigh in favor of a permanent industry bar for Eichler in accordance with Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act. First, Eichler acted with a high degree of scienter. The severity of his fraud is most evident in the case of the 483 "perfect information" trades, where he knew the outcome of the trade before he allocated the position. He made roughly \$1 million in trading profits on these trades and was only able to reap this benefit by breaching his fiduciary duty to the Insider Hedge Funds. Although the disfavored hedge funds were responsible for nearly half of all capital invested in "perfect information" trades, they received none of the profits from those trades, the majority of which Eichler had allocated to himself. Eichler thus used the disfavored hedge funds as a trash

bin for speculative option bets that did not pan out. That he did this with calculated intent is borne out by his habitual practice of “cancelling-and-rebooking” option trades to and from the disfavored hedge funds’ allocation account during the first year of the relevant period. Eichler cannot dispute that he defrauded his advisory clients.

Second, Eichler’s cherry-picking was neither an isolated occurrence, nor a reckless mistake. Over a 27-month period, Eichler late-allocated thousands of option trades. On “perfect information” trades alone, Eichler cherry-picked dozens of trades for his personal trading account, almost all of which represented a guaranteed trading profit. Moreover, Eichler is a recidivist. In 2011, Eichler was censured by the SEC, ordered to cease and desist from committing further securities law violations, and fined a civil penalty in the amount of \$100,000; yet all the while, Eichler contemporaneously persisted in his cherry-picking scheme to defraud. Leung Decl., Ex. 6 (May 9, 2011 administrative cease-and-desist order against Eichler).

Third, and taking into consideration the above, the Presiding Judge should take a dim view of any assurances that Eichler may make that he will not violate the federal securities laws in the future, or that he recognizes the wrongful character of his actions. There is a strong likelihood that future violations by Eichler might occur, if only because we know, from very recent history, that Eichler has repeatedly run afoul of the federal securities laws. Finally, Eichler’s misconduct resulted in substantial investor losses. The disfavored hedge funds sustained losses of at least \$2.3 million because of the cherry-picking scheme, while Eichler made wrongful profits of \$1.655 million.

On the balance of the *Steadman* factors, Eichler should be permanently barred from the industry. He engaged in a scheme to defraud with scienter – one which allowed him to personally reap an illegal windfall of more than \$1.65 million, at the expense of \$2.3 million in

investor losses. That kind of conduct warrants nothing less than permanent exclusion.

**IV. CONCLUSION**

Accordingly, the Division respectfully requests that its motion for summary disposition be granted, and that Eichler be permanently barred pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act.

Dated: February 12, 2016

Respectfully submitted,

DIVISION OF ENFORCEMENT



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**IN THE MATTER OF PETER J. EICHLER, JR.**

**Administrative Proceeding File No. 3-17003  
Service List**

Pursuant to Commission Rule of Practice 151 (17 C.F.R. § 201.151), I certify that the attached:

**DIVISION OF ENFORCEMENT'S  
MOTION FOR SUMMARY DISPOSITION**

was filed with the Office of the Secretary of the Commission and served by electronic mail and UPS Overnight Mail on February 12, 2016, upon the following parties as follows:

Brent J. Fields, Secretary  
Securities and Exchange Commission  
100 F. Street, N.E., Mail Stop 1090  
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(Original and three copies)

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(By Email and U.S. Mail)

Dated: February 12, 2016

  
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**CALIFORNIA ALL-PURPOSE ACKNOWLEDGMENT**

CIVIL CODE § 1169

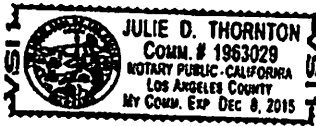
State of California

County of Los Angeles }

On Nov 4, 2013 before me, Julie D Thornton, a Notary Public  
Date Here Insert Name and Title of the Officer

personally appeared Peter J. Eichler  
Name(s) of Signer(s)

who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/hers/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.



I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal

Signature: [Handwritten Signature]  
Signature of Notary Public

Place Notary Seal Above

**OPTIONAL**

*Though the information below is not required by law, it may prove valuable to persons relying on the document and could prevent fraudulent removal and reattachment of this form to another document*

**Description of Attached Document**

Title or Type of Document: Stipulated Judgement / Consent

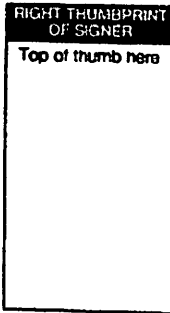
Document Date: Nov 4, 2013 Number of Pages: \_\_\_\_\_

Signer(s) Other Than Named Above: Robert H. Hatz, Jr

**Capacity(ies) Claimed by Signer(s)**

Signer's Name: \_\_\_\_\_

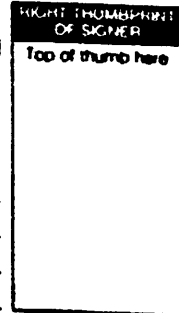
- Corporate Officer — Title(s): \_\_\_\_\_
- Individual
- Partner —  Limited  General
- Attorney in Fact
- Trustee
- Guardian or Conservator
- Other: \_\_\_\_\_



Signer is Representing: \_\_\_\_\_

Signer's Name: \_\_\_\_\_

- Corporate Officer — Title(s): \_\_\_\_\_
- Individual
- Partner —  Limited  General
- Attorney in Fact
- Trustee
- Guardian or Conservator
- Other: \_\_\_\_\_



Signer is Representing: \_\_\_\_\_



**PROOF OF SERVICE**

I am over the age of 18 years and not a party to this action. My business address is:

U.S. SECURITIES AND EXCHANGE COMMISSION, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036-3648  
Telephone No. (323) 965-3998; Facsimile No. (323) 965-3908.

On November 6, 2013, I caused to be served the document entitled **CONSENT OF PETER J. EICHLER** on all the parties to this action addressed as stated on the attached service list:

**OFFICE MAIL:** By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency's practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.

**PERSONAL DEPOSIT IN MAIL:** By placing in sealed envelope(s), which I personally deposited with the U.S. Postal Service. Each such envelope was deposited with the U.S. Postal Service at Los Angeles, California, with first class postage thereon fully prepaid.

**EXPRESS U.S. MAIL:** Each such envelope was deposited in a facility regularly maintained at the U.S. Postal Service for receipt of Express Mail at Los Angeles, California, with Express Mail postage paid.

**HAND DELIVERY:** I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.

**UNITED PARCEL SERVICE:** By placing in sealed envelope(s) designated by United Parcel Service ("UPS") with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.

**ELECTRONIC MAIL:** By transmitting the document by electronic mail to the electronic mail address as stated on the attached service list.

**E-FILING:** By causing the document to be electronically filed via the Court's CM/ECF system, which effects electronic service on counsel who are registered with the CM/ECF system.

**FAX:** By transmitting the document by facsimile transmission. The transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct.

Date: November 6, 2013

/s/ Gary Y. Leung  
Gary Y. Leung

**SEC v. ALETHEIA RESEARCH AND MANAGEMENT, INC., ET AL.**

**United States District Court – Central District of California**

**Case No. CV 12-10692-JFW (RZx)**

**SERVICE LIST**

Robert H. Hotz, Jr.  
Estela Diaz  
Akin Gump Strauss  
Hauer & Feld LLP  
399 Park Ave  
New York, NY 10022  
*Attorneys for Peter J. Eichler, Jr.*

Brian A. Bash  
BakerHostetler  
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1900 East 9th Street, Suite 3200  
Cleveland, OH 44114-3482  
(216) 861-7581  
*Attorney for Jeffrey Golden, Trustee  
for Aletheia Research and  
Management, Inc.*

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## Requests

[2:12-cv-10692-JFW-RZ](#)  
[Securities and Exchange](#)  
[Commission v. Aletheia](#)  
[Research and Management Inc](#)  
[et al](#)

(RZx),DISCOVERY,MANADR

### UNITED STATES DISTRICT COURT for the CENTRAL DISTRICT OF CALIFORNIA

#### Notice of Electronic Filing

The following transaction was entered by Leung, Gary on 11/6/2013 at 3:49 PM PST and filed on 11/6/2013

**Case Name:** Securities and Exchange Commission v. Aletheia Research and Management Inc et al  
**Case Number:** [2:12-cv-10692-JFW-RZ](#)  
**Filer:** Securities and Exchange Commission  
**Document Number:** [31](#)

#### Docket Text:

**REQUEST for Judgment as to Defendant Peter J. Eichler, Jr. filed by Plaintiff Securities and Exchange Commission. (Attachments: # (1) Consent of Peter J. Eichler)(Leung, Gary)**

#### 2:12-cv-10692-JFW-RZ Notice has been electronically mailed to:

Estela Diaz ediaz@akingump.com

Gary Y Leung LeungG@sec.gov, delgadilloj@sec.gov, larofiling@sec.gov

Hyongsoon Kim kimh@akingump.com, iedwards@akingump.com

Janet E. Moser moserj@sec.gov

John B Bulgozdy bulgozdyj@sec.gov, cavallones@sec.gov, irwinma@sec.gov,  
LAROFiling@sec.gov

Joshua David Nelson Hess joshua.hess@dechert.com

Robert A Robertson robert.robertson@dechert.com

Robert H Hotz , Jr rhotz@akingump.com

2:12-cv-10692-JFW-RZ Notice has been delivered by First Class U. S. Mail or by other means **BY**



**THE FILER to :**

The following document(s) are associated with this transaction:

**Document description:**Main Document

**Original filename:**C:\Users\delgadilloj\Desktop\Proposed Judgment -- Eichler Bifurcated Consent.pdf

**Electronic document Stamp:**

[STAMP cacdStamp\_ID=1020290914 [Date=11/6/2013] [FileNumber=16527784-0]  
] [a61428dfc964ec79cf5f0c520ae1b371ef689f2ac572c63e210669b7ac3b97a19ab  
7ee035b9367a45a9a100d6ff9c87256a3a37459d237be3fdb57e617b6555e]]

**Document description:** Consent of Peter J. Eichler

**Original filename:**C:\Users\delgadilloj\Desktop\Eichler bifurcated consent (FINAL).pdf

**Electronic document Stamp:**

[STAMP cacdStamp\_ID=1020290914 [Date=11/6/2013] [FileNumber=16527784-1]  
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b9a78607178e62c2ab4fa588772be97a7a92393350c0fb895f275e25fce6d]]



# **EXHIBIT 3**

1 JOHN B. BULGOZDY, Cal. Bar No. 219897

Email: [bulgozdyj@sec.gov](mailto:bulgozdyj@sec.gov)

2 GARY Y. LEUNG, L.R. 83-2.4.1 leave to practice granted

Email: [leungg@sec.gov](mailto:leungg@sec.gov)

3 JANET E. MOSER, Cal. Bar No. 199171

Email: [moserj@sec.gov](mailto:moserj@sec.gov)

4 Attorneys for Plaintiff  
5 Securities and Exchange Commission  
6 Michele Wein Layne, Regional Director  
7 Lorraine B. Echavarria, Associate Regional Director  
8 John W. Berry, Regional Trial Counsel  
9 5670 Wilshire Boulevard, 11th Floor  
10 Los Angeles, California 90036  
11 Telephone: (323) 965-3998  
12 Facsimile: (323) 965-3908

JS-6

10 UNITED STATES DISTRICT COURT  
11 CENTRAL DISTRICT OF CALIFORNIA

13 SECURITIES AND EXCHANGE  
14 COMMISSION,

15 Plaintiff,

16 vs.

17 ALETHEIA RESEARCH AND  
18 MANAGEMENT, INC., and PETER J.  
19 EICHLER, JR.,

20 Defendants.

Case No. CV12-10692 JFW (RZx)

**JUDGMENT AS TO DEFENDANT  
PETER J. EICHLER, JR.**

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1 The Securities and Exchange Commission (the "SEC") having filed a  
2 Complaint and Defendant Peter J. Eichler, Jr. ("Eichler") having entered a general  
3 appearance and having consented to the Court's jurisdiction over Defendant and  
4 the subject matter of this action:

5 I.

6 IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Eichler  
7 and Eichler's agents, servants, employees, attorneys, and all persons in active  
8 concert or participation with them who receive actual notice of this Final Judgment  
9 by personal service or otherwise are permanently restrained and enjoined from  
10 violating, directly or indirectly, Section 10(b) of the Securities Exchange Act of  
11 1934 (the "Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated  
12 thereunder [17 C.F.R. § 240.10b-5], by using any means or instrumentality of  
13 interstate commerce, or of the mails, or of any facility of any national securities  
14 exchange, in connection with the purchase or sale of any security:

- 15 (a) to employ any device, scheme, or artifice to defraud;
- 16 (b) to make any untrue statement of a material fact or to omit to state a  
17 material fact necessary in order to make the statements made, in the  
18 light of the circumstances under which they were made, not  
19 misleading; or
- 20 (c) to engage in any act, practice, or course of business which operates or  
21 would operate as a fraud or deceit upon any person.

22 II.

23 IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Eichler  
24 and Eichler's agents, servants, employees, attorneys, and all persons in active  
25 concert or participation with them who receive actual notice of this Final Judgment  
26 by personal service or otherwise are permanently restrained and enjoined from  
27 violating, directly or indirectly, Sections 206(1), 206(2) and 206(4) of the  
28

1 Investment Advisers Act of 1940 (“Advisers Act”) [15 U.S.C. § 80b-6(1), (2) and  
2 (4)] and Rule 206(4)-8(a) promulgated thereunder [17 C.F.R. § 275.206(4)-8(a)],  
3 by using any means or instrumentality of interstate commerce, or of the mails, or  
4 of any facility of any national securities exchange:

- 5 (a) to employ any device, scheme, or artifice to defraud any client or  
6 prospective client;
- 7 (b) to engage in any transaction, practice, or course of business which  
8 operates as a fraud or deceit upon any client or prospective client; or
- 9 (c) to engage in any act, practice, or course of business which is  
10 fraudulent, deceptive, or manipulative.

11 III.

12 IT IS HEREBY FURTHER ORDERED, ADJUDGED, AND DECREED  
13 that Defendant Eichler is liable for disgorgement of \$1,655,923, representing  
14 profits gained as a result of the conduct alleged in the Complaint, together with  
15 prejudgment interest thereon in the amount of \$41,749.35, for a total of  
16 \$1,697,672.35.

17 Defendant Eichler filed for bankruptcy protection under Chapter 7 of the  
18 Bankruptcy Code on or about December 19, 2013 (*see In re Peter J. Eichler, Jr.*,  
19 Case. No. 2:13-bk-39626-RK (Bankr. C.D. Cal.)). Subject to applicable  
20 bankruptcy law, Defendant Eichler shall satisfy this obligation by paying  
21 \$1,697,672.35 to the Securities and Exchange Commission within 14 days after  
22 entry of this Final Judgment, or at such point as permitted under applicable  
23 bankruptcy law.

24 Defendant Eichler may transmit payment electronically to the SEC, which  
25 will provide detailed ACH transfer/Fedwire instructions upon request. Payment  
26 may also be made directly from a bank account via Pay.gov through the SEC  
27 website at <http://www.sec.gov/about/offices/ofm.htm>. Defendant Eichler may also



1 pay by certified check, bank cashier's check, or United States postal money order  
2 payable to the Securities and Exchange Commission, which shall be delivered or  
3 mailed to

4 Enterprise Services Center  
5 Accounts Receivable Branch  
6 6500 South MacArthur Boulevard  
7 Oklahoma City, OK 73169

8 and shall be accompanied by a letter identifying the case title, civil action number,  
9 and name of this Court; Peter J. Eichler, Jr. as a defendant in this action; and  
10 specifying that payment is made pursuant to this Final Judgment.

11 Defendant Eichler shall simultaneously transmit photocopies of evidence of  
12 payment and case identifying information to the SEC's counsel in this action. By  
13 making this payment, Defendant Eichler relinquishes all legal and equitable right,  
14 title, and interest in such funds and no part of the funds shall be returned to  
15 Defendant Eichler.

16 The SEC shall hold the funds (collectively, the "Fund") and may propose a  
17 plan to distribute the Fund subject to the Court's approval. The Court shall retain  
18 jurisdiction over the administration of any distribution of the Fund. If the SEC  
19 staff determines that the Fund will not be distributed, the SEC shall send the funds  
20 paid pursuant to this Final Judgment to the United States Treasury.

21 Subject to applicable bankruptcy law, the SEC may enforce the Court's  
22 judgment for disgorgement and prejudgment interest by moving for civil contempt  
23 (and/or through other collection procedures authorized by law) at any time after 14  
24 days following entry of this Final Judgment, or at such point as permitted under  
25 applicable bankruptcy law. Defendant Eichler shall pay post judgment interest on  
26 any delinquent amounts pursuant to 28 U.S.C. § 1961.  
27  
28

1 IV.

2 IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that  
3 Defendant Eichler shall pay a civil penalty in the amount of \$1,655,923 to the  
4 Securities and Exchange Commission pursuant to Section 21(d)(3)(A) of the  
5 Exchange Act, 15 U.S.C. § 78u(d)(3)(A) and Section 209(e) of the Advisers Act,  
6 15 U.S.C. § 80b-9(e)(2)(C).

7 Defendant Eichler filed for bankruptcy protection under Chapter 7 of the  
8 Bankruptcy Code on or about December 19, 2013 (*see In re Peter J. Eichler, Jr.*,  
9 Case. No. 2:13-bk-39626-RK (Bankr. C.D. Cal.)). Subject to applicable  
10 bankruptcy law, Defendant Eichler shall make this payment within 14 days after  
11 entry of this Final Judgment, or at such point as permitted under applicable  
12 bankruptcy law.

13 Defendant Eichler may transmit payment electronically to the SEC, which  
14 will provide detailed ACH transfer/Fedwire instructions upon request. Payment  
15 may also be made directly from a bank account via Pay.gov through the SEC  
16 website at <http://www.sec.gov/about/offices/ofm.htm>. Defendant Eichler may also  
17 pay by certified check, bank cashier's check, or United States postal money order  
18 payable to the Securities and Exchange Commission, which shall be delivered or  
19 mailed to

20 Enterprise Services Center  
21 Accounts Receivable Branch  
22 6500 South MacArthur Boulevard  
23 Oklahoma City, OK 73169

24 and shall be accompanied by a letter identifying the case title, civil action number,  
25 and name of this Court; Peter J. Eichler, Jr. as a defendant in this action; and  
26 specifying that payment is made pursuant to this Final Judgment.

27 Defendant Eichler shall simultaneously transmit photocopies of evidence of  
28 payment and case identifying information to the SEC's counsel in this action. By

1 making this payment, Defendant Eichler relinquishes all legal and equitable right,  
2 title, and interest in such funds and no part of the funds shall be returned to  
3 Defendant Eichler. The SEC shall send the funds paid pursuant to this Final  
4 Judgment to the United States Treasury.

5 V.

6 IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that  
7 Defendant Eichler's Consent (Dkt. No. 31) is incorporated herein with the same  
8 force and effect as if fully set forth herein, and that Defendant Eichler shall comply  
9 with all of the undertakings and agreements set forth therein.

10 VI.

11 IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that this  
12 Court shall retain jurisdiction over this matter for the purpose of enforcing the  
13 terms of this Final Judgment.

14  
15 Dated: May 11, 2015

  
UNITED STATES DISTRICT  
JUDGE JOHN F. WALTER

**EXHIBIT 4**

**United States District Court  
Central District of California**

SECURITIES AND EXCHANGE  
COMMISSION,

Plaintiff,

vs.

ALETHEIA RESEARCH AND  
MANAGEMENT, INC., and PETER J.  
EICHLER, JR.,

Defendants.

Case No.: CV12-10692-JFW (RZx)

**Report of David W. Prager**

Managing Director  
Goldin Associates, LLC

August 26, 2013

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## I. Qualifications and Purpose of Report

1. I am a Managing Director of Goldin Associates, LLC (“Goldin”), a financial advisory and consulting firm.
2. I am a Chartered Financial Analyst (“CFA”) charterholder. I received the right to use the CFA designation after passing a series of examinations covering various forms of financial analyses, including statistical analysis.
3. I am a member of the New York Society of Securities Analysts, the CFA Institute, the American Bankruptcy Institute, and the Turnaround Management Association. I hold a B.S. in Economics from the Wharton School at the University of Pennsylvania.
4. I have spent nearly 15 years performing complex financial analysis, primarily in connection with litigation support, turnaround and crisis management, and bankruptcy consulting. I am an experienced financial professional and have provided expert testimony, litigation support, financial advice and interim management in major matters for companies and their creditors. My practice has focused on complex financial matters and business problems, including the application of intricate financial modeling and analysis to corresponding business principles.
5. I have provided litigation support in many matters respecting trading and investment management irregularities, complex structured products, complicated financial settlements and allocation of value. I have provided business and strategic guidance (including litigation support and testimony) and concomitant analytical support in the restructurings of and/or litigation matters pertaining to companies such as Tribune, Adelphia Communications, MBIA, FGIC, Enron, NorthWestern and SemGroup. I currently serve as the chief executive officer of The PMI Group, Inc. and previously was the principal financial officer of Syncora Holdings Ltd., both of which are publicly-traded insurance holding companies. My *curriculum vitae* is attached as Exhibit A.
6. Goldin has been retained by the Securities and Exchange Commission (“SEC”) to provide analysis and testimony in connection with the above-captioned matter. Goldin has been compensated for my work at a rate of \$616.50 per hour.<sup>1</sup> I am independent of the plaintiff and the defendant in this matter. I have been assisted in my work on this case by my colleagues at Goldin, for whose work Goldin is being paid its usual and customary rate, adjusted for a 10 percent government discount. Goldin’s compensation is not contingent upon the conclusions of this Report. A list of materials that I considered in forming the opinions expressed in this Report is attached as Exhibit B.

---

<sup>1</sup> This represents my usual and customary rate adjusted for a 10% government discount.

## II. Background of Case

7. Aletheia Research and Management, Inc., a registered investment advisor (“Aletheia”), managed:
  - Separate client accounts following four investing strategies – Aletheia Growth, Aletheia Value, Aletheia International Growth and Aletheia Balanced. Certain institutional clients’ strategy accounts were customized based on client-imposed limitations;<sup>2</sup>
  - A hedge fund product managed in two vehicles, the Aletheia Insider Index and the Aletheia Insider Index II (collectively, the “Hedge Funds”).<sup>3</sup> The two vehicles were separated due to a limit on the number of investors per vehicle, but were managed identically;<sup>4</sup> and
  - Accounts managed on behalf of Aletheia’s chairman, Chief Executive Officer and Chief Investment Officer, Peter J. Eichler, Jr. (“Eichler” and, together with Aletheia, the “Defendants”) and his family (“Eichler Accounts”), Aletheia employees (“Employee Accounts”), certain Aletheia proprietary accounts (the “Aletheia Accounts”) and other individuals at trust (“Custom Accounts”).<sup>5</sup> These accounts are referred to collectively herein as the “Favored Accounts.”
8. Each of these classes of accounts invested in stocks, options and/or bonds. The various classes of accounts did not have separate management or investment teams; rather, Eichler made substantially all investment decisions.<sup>6</sup> In some cases, several accounts acquired positions in the securities of the same companies.<sup>7</sup> When Aletheia traded in a security or at some point thereafter, Eichler would decide to which account or accounts to allocate a given trade.<sup>8</sup>
9. This Report focuses on the execution of options trades by the Defendants between August 13, 2009 and November 30, 2011 (the “Relevant Period”).<sup>9</sup> During the Relevant Period, Aletheia executed 4,938 options trades – both puts and calls – over a total of 600 trading days. Of these trades, Eichler allocated 1,934 (39.2%) options trades within one hour<sup>10</sup> of

<sup>2</sup> See Wells Submission on behalf of Aletheia Research and Management, Inc. and Peter J. Eichler, Jr. II(A)

<sup>3</sup> See Wells Submission II(B)

<sup>4</sup> See ARMISEC0001384. See also Eichler dep. 76:1-19

<sup>5</sup> See Wells Submission II(C)

<sup>6</sup> See Roper dep. 55:12-23, Eichler dep. 60:19

<sup>7</sup> See Roper dep. 177:9-11, Eichler dep. 69:12-21

<sup>8</sup> See Barnes dep. 122:4-123:11, Roper dep. 63:4-19, 118:6-7

<sup>9</sup> I have been advised by the SEC that the Relevant Period is the only time period for which the options trading data (i.e., execution and allocation time) necessary to perform the analysis herein is available in the evidentiary record.

<sup>10</sup> The primary analysis in this Report assumes that Aletheia employees may have required up to one hour to process and enter an allocation that had been determined prior to execution. This means that certain trades counted in the Timely Allocated Trades category herein may actually have been improperly late allocated trades. While the primary analysis in the body of this Report considers trades allocated within one hour of execution to be Timely Allocated Trades, Appendix 1 hereto repeats that analysis by alternatively distinguishing Timely Allocated Trades as those allocated (a) within 15 minutes of execution, (b) within 2 hours of execution, and (c) after the close of



executing the trade (“Timely Allocated Trades”) and 3,004 (60.8%) options trades one hour or longer after executing the trade (“Late Allocated Trades”).

**Figure 1:**

Timeliness of All Options Trades Allocations		
	# of Trades	% of Total
Timely	1,934	39.2%
Late	3,004	60.8%
<b>Total</b>	<b>4,938</b>	<b>100%</b>

10. By the time Eichler communicated which of the accounts would receive the Late Allocated Trades, the prices of the options had often moved, thereby embedding a profit or loss in the trades at the time of allocation. For example, if an option were purchased for \$1.00 per share, but had increased to \$1.50 by the time it was allocated, the account receiving the allocation would be allocated a built-in mark-to-market \$0.50 profit per share. If, instead, that same option were to have decreased in price to \$0.50 by the time it was allocated, the account receiving the allocation would receive a built-in mark-to-market loss of \$0.50 per share.
11. Prior to allocating 483 of the Late Allocated Trades, the Defendants had already sold the position at issue (“Perfect Information Trades”). As such, profit or loss on such trades would have been known and realized with certainty prior to allocating the trade to an account. Under these circumstances it was not that a trade was being allocated, but, rather, that known profit or loss was being allocated.<sup>11</sup>
12. With embedded profit or loss known at the time of allocation, a manager could then “cherry pick” more profitable trades (*i.e.*, trades which had appreciated prior to allocation) for disproportionate allocation to an advantaged account and less profitable trades for disproportionate allocation to a disadvantaged account. The SEC alleges that the Defendants cherry picked by disproportionately allocating profitable Late Allocated Trades for the improper benefit of the Favored Accounts, including the Eichler Accounts.<sup>12</sup> Conversely, the SEC alleges that Eichler cherry picked unprofitable Late Allocated Trades for disproportionate allocation to and to the detriment of the Hedge Funds.

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business on the day of execution. Under all three alternative definitions of “Late Allocated Trades,” the Favored Accounts’ Late Allocated Trades outperformed both the Favored Accounts’ Timely Allocated Trades and the Late Allocated Trades as a whole, while the Hedge Funds’ Late Allocated Trades underperformed both the Hedge Funds’ Timely Allocated Trades and the Late Allocated Trades as a whole.

<sup>11</sup> See Murray Report at 9

<sup>12</sup> See *S.E.C. v. Aletheia Research and Mgmt. Inc., et al.*, No. 12 Cir. 10692 (C.D. Cal.), Compl. ¶2

13. The analysis herein indicates that:

- Late Allocated Trades allocated to the *Favored Accounts* greatly outperformed Timely Allocated Trades allocated to those accounts;
- Late Allocated Trades allocated to the *Favored Accounts* greatly outperformed Late Allocated Trades as a whole;
- Late Allocated Trades allocated to the *Hedge Funds* greatly underperformed Timely Allocated Trades allocated to the Hedge Funds; and
- Late Allocated Trades allocated to the *Hedge Funds* greatly underperformed Late Allocated Trades as a whole.

**Figure 2:**

**Comparison of Late Allocated Trade Performance to Timely Allocated Trade Performance**

	Profitable % of Trades			End of Day Return		
	Late Allocated	Timely Allocated	Disparate Performance	Late Allocated	Timely Allocated	Disparate Performance
Favored Accounts	54.0%	22.0%	32.0%	4.7%	-3.7%	8.3%
Aletheia Accounts	55.0%	34.8%	20.2%	4.0%	-1.5%	5.5%
Custom Accounts	53.5%	21.2%	32.3%	2.7%	-4.4%	7.1%
Eichler Accounts	52.8%	24.2%	28.6%	6.9%	-3.2%	10.1%
Employee Accounts	66.7%	15.3%	51.4%	9.4%	-3.6%	12.9%
Hedge Funds	29.6%	35.0%	-5.3%	-6.6%	-2.1%	-4.5%

14. For example, as demonstrated above, while only 22.0% of the Favored Accounts' Timely Allocated Trades were profitable at the end of the day, 54.0% of the same Favored Accounts' Late Allocated Trades were profitable at that time. Similarly, the Favored Accounts' Timely Allocated Trades *lost* on average 3.7% on the day of trade compared to a 4.7% *profit* for the Favored Accounts' Late Allocated Trades, an increased return of 8.3%.
15. The same phenomena were present with respect to the Eichler Accounts' Late Allocated Trades, which were 10.1% more profitable than Timely Allocated Trades—*earning* 6.9% compared to *losing* 3.2%. Likewise, the Eichler Accounts' Late Allocated Trades were more than twice as likely to be profitable as were the Eichler Accounts' Timely Allocated Trades (52.8% compared to 24.2%).
16. Conversely, the Hedge Funds' Late Allocated Trades were 4.5% less successful than their Timely Allocated Trades (6.6% loss versus 2.1% loss).
17. The performance analyzed above and throughout this Report is based on profit and loss embedded on the day of allocation, as this was the information available to the Defendants for evaluation at the time of allocation.

18. This Report addresses the extent to which the Disparate Performance<sup>13</sup> is the result of either (a) difference in the investment strategies of the accounts or (b) random allocation of built-in or realized returns. Disparate Performance that is inconsistent with either investment strategy or random allocation is indicative of cherry picking benefiting the Favored Accounts. This Report also considers the extent to which such potential manipulation benefited the Favored Accounts and harmed the Hedge Funds.

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<sup>13</sup> The outperformance of the Favored Accounts and underperformance of the Hedge Funds are collectively referred to as the “Disparate Performance.”



### III. Summary of Conclusions

19. The allegations of cherry picking of trades in this case rest on two pre-requisites:

- a) Because of late allocation, knowledge of the built-in profit or loss was available at the time of allocation; *and*
- b) The built-in profit was allocated disproportionately to the Favored Accounts and built-in loss was allocated disproportionately to the Hedge Funds.

The Disparate Performance may not be inappropriate to the extent it was:

- a) Consistent with differences in investment strategy performance (as represented by the return on Timely Allocated Trades); *or*
- b) The result of random allocation.

**However, neither of these mitigating factors is present in this case.**

20. **Within each class of accounts, the Disparate Performance could not have occurred if the Timely Allocated Trades and Late Allocated Trades had all been invested pursuant to a consistent investment strategy for each respective account class.**

- It is with greater than 99% statistical confidence that allocation consistent with overall investment strategies could not account for (i) the Favored Accounts having (a) received a higher proportion of winning (versus losing) trades and (b) generated higher returns when the trades were late allocated with embedded profit, compared to when such trades were timely allocated without embedded profit and (ii) the Hedge Funds having (a) received a lower proportion of winning (versus losing) trades and (b) generated lower returns when the trades were late allocated with embedded profit or loss, compared to when such trades were timely allocated without embedded profit.
- The Favored Accounts likely profited by at least an incremental \$4.1 million, while the Hedge Funds likely suffered an incremental loss of at least \$3.0 million as a result of the Disparate Performance.

21. **Nor was the Disparate Performance the result of random allocation of the Late Allocated Trades among account classes.** With greater than 99.99% statistical confidence, random distribution did not account for (i) the Favored Accounts having received (a) a higher proportion of winning (versus losing) trades and (b) higher embedded profit, than were they allocated a random sample of the Late Allocated Trades, and (ii) the Hedge Funds having received (a) a lower proportion of winning (versus losing) trades and (b) lower returns, than were they allocated a random sample of Late Allocated Trades. The Favored Accounts likely benefited by an incremental built-in profit of \$3.2 million while the Hedge

Funds likely suffered an incremental built-in loss of like amount as a result of the Disparate Performance.

22. Perfect Information Trades cannot be expected to reflect any investment strategy return; by definition, at the time of allocation these “trades” were simply realized profit and loss amounts. **The guaranteed profit and loss associated with the Perfect Information Trades was allocated in a manner wholly inconsistent with capital deployed in options trading.** The Favored Accounts likely benefited by an incremental guaranteed profit of \$1.8 million as a result of the Perfect Information Trades while the Hedge Funds likely forewent an incremental guaranteed profit of like amount.
23. The level of built-in return of a Late Allocated Trade predicts, with a high degree of predictive power, the probability that the associated profit or loss was allocated to the Hedge Funds (rather than the Favored Accounts). In other words, the amount of return on a Late Allocated Trade explains with 84% accuracy the actual allocation of profit or loss associated with such a trade. When investment returns on given Late Allocated Trades *increase* by 10%, the probability that the associated profit will be allocated to the Hedge Funds *declines* by 11.2%. **It is clear that increased built-in returns were a predominant factor in determining to allocate Late Allocated Trades to the Favored Accounts.**



**IV. The Late Allocated Trades were Inconsistent with the Accounts' Overall Performance**

24. Were the late allocation of trades simply a result of poor record keeping and trade execution practices, for each account class the return on Late Allocated Trades should reflect the same investment strategies as, and therefore approximate the returns earned on, the Timely Allocated Trades.
25. The following table sets forth the percentage of trades that were profitable and end-of-day profit for Late Allocated Trades and Timely Allocated Trades for each account class.

**Figure 3:**

**Comparison of Late Allocated Trade Performance to Timely Allocated Trade Performance**

	Profitable % of Trades			End of Day Return		
	Late Allocated	Timely Allocated	Disparate Performance	Late Allocated	Timely Allocated	Disparate Performance
Favored Accounts	54.0%	22.0%	32.0%	4.7%	-3.7%	8.3%
Aletheia Accounts	55.0%	34.8%	20.2%	4.0%	-1.5%	5.5%
Custom Accounts	53.5%	21.2%	32.3%	2.7%	-4.4%	7.1%
Eichler Accounts	52.8%	24.2%	28.6%	6.9%	-3.2%	10.1%
Employee Accounts	66.7%	15.3%	51.4%	9.4%	-3.6%	12.9%
Hedge Funds	29.6%	35.0%	-5.3%	-6.6%	-2.1%	-4.5%

26. As the table above demonstrates, the Favored Accounts exhibited enhanced intra-day success (both in terms of percentage of successful trades and profitability) among their Late Allocated Trades relative to their Timely Allocated Trades. Conversely, the Hedge Funds' Late Allocated Trades exhibited diminished intra-day success compared to Timely Allocated Trades.
27. To be sure, there is no reason to expect an account class's Late Allocated Trades to exhibit *exactly* the same performance as its Timely Allocated Trades. Random deviations could exist, but they should be relatively small and predictable. For example, were one to flip a coin 100 times and it landed on heads 51 times, one would not conclude that the coin was unevenly weighted. However, were that coin to land on heads 65 times, one would conclude with a high degree of certainty that the coin was weighted to favor heads.
28. As described further in Appendix 2 to this report, a statistical level of confidence that the Disparate Performance is not the result of sampling difference can be analyzed by reference to a "Z Score." A higher Z Score represents a greater likelihood that the Disparate Performance is not mere coincidence, but reflective of some design. For example, a Z Score of 1.28 reflects a 90% statistical confidence that the Disparate Performance is not mere coincidence and a Z Score of 2.32 reflects 99% statistical confidence.

29. The following table sets forth the statistical level of confidence with which the Favored Accounts' Late Allocated Trades outperformed (and the Hedge Funds' Late Allocated Trades underperformed) their respective Timely Allocated Trades.

**Figure 4:**

**Disparate Performance of Late Allocated and Timely Allocated Trades**

	Profitable % of Trades		End of Day Return	
	Z Scores	Confidence	Z Scores	Confidence
Favored Accounts	16.49	>99.99%	15.01	>99.99%
Aletheia Accounts	2.84	99.77%	2.80	99.74%
Custom Accounts	11.08	>99.99%	10.86	>99.99%
Eichler Accounts	8.58	>99.99%	9.10	>99.99%
Employee Accounts	8.47	>99.99%	6.51	>99.99%
Hedge Funds	-2.52	99.43%	-7.59	>99.99%

30. **These results indicate clearly that within each class of accounts the Disparate Performance could not have occurred if the Timely Allocated Trades and Late Allocated Trades had all been invested pursuant to a consistent investment strategy for each respective account class.** For example, it is with greater than 99.99% statistical confidence that allocation consistent with overall investment strategies could not account for the Eichler Accounts having (a) received a higher proportion of winning (versus losing) trades and (b) generated higher returns when the trades were late allocated with embedded profit than when they were timely allocated without embedded profit. Conversely, the Hedge Funds (a) received a lower proportion of winning (versus losing) trades (with 99.43% confidence) and (b) generated lower returns when the trades were late allocated with embedded profit or loss than when they were timely allocated without embedded profit or loss (with greater than 99.99% confidence).
31. The Disparate Performance benefited the Favored Accounts at the expense of the Hedge Funds. The following table calculates the incremental profit earned or loss suffered by each account class by investing in the Late Allocated Trades rather than investing the same funds in trades substantially similar to the Timely Allocated Trades.



**Figure 5:**

**Incremental Profit Earned or Lost Relative to Timely Allocated Trades**

	Avg Return			Late Allocated Trades \$ Invested	Incremental Profit		
	Late Allocated	Timely Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	4.7%	-3.7%	8.3%	\$49,868,697	\$4,109,645	\$3,465,659	\$3,279,507
Aletheia Accounts	4.0%	-1.5%	5.5%	\$5,514,590	\$302,214	\$163,986	\$124,030
Custom Accounts	2.7%	-4.4%	7.1%	\$23,166,587	\$1,644,373	\$1,450,636	\$1,394,634
Eichler Accounts	6.9%	-3.2%	10.1%	\$20,101,504	\$2,022,500	\$1,738,125	\$1,655,923
Employee Accounts	9.4%	-3.6%	12.9%	\$1,086,016	\$140,559	\$112,912	\$104,921
Hedge Funds	-6.6%	-2.1%	-4.5%	\$65,967,184	(\$2,954,106)	(\$2,456,223)	(\$2,312,303)

32. This analysis suggests the Favored Accounts likely profited by an incremental \$4.1 million while the Hedge Funds likely suffered an incremental loss of \$3.0 million as a result of the Disparate Performance. With 95% statistical confidence, the Favored Accounts incrementally profited by **at least** \$3.3 million and the Hedge Funds suffered **at least** \$2.3 million in incremental loss.<sup>14</sup>

<sup>14</sup> The amount of incremental profit earned by the Favored Accounts does not exactly equal the amount of incremental loss suffered by the Hedge Funds, because the return on Late Allocated Trades in total exceeds the return on Timely Allocated Trades in total. Any adjustment to reflect that Late Allocated Trades overall were more profitable than Timely Allocated Trades overall would increase the Disparate Performance and incremental loss suffered by the Hedge Funds.



V. The Late Allocated Trades were not Randomly Allocated to Accounts

33. As demonstrated above, the late allocation of trades was not simply a result of poor record keeping and trade execution practices. Alternatively, the Disparate Performance may have resulted from a random allocation of trades, rather than cherry picking. But, were the Late Allocated Trades allocated without either regard to investment strategy or the intent to benefit the Favored Accounts or harm the Hedge Funds, the returns on Late Allocated Trades for a specific account class should approximate the returns earned on all Late Allocated Trades.
34. The following table illustrates that each of the Favored Account classes was allocated a higher percentage of profitable Late Allocated Trades and built-in profit than was allocated to the Hedge Funds. The Late Allocated Trades allocated to the Favored Accounts contained built-in *profit* at time of allocation of 4.6%. By contrast, the Hedge Funds' Late Allocated Trades were substantially *impaired* by 6.7% at the time of allocation.

**Figure 6:**

**Comparison of Account Late Allocated Trades to All Late Allocated Trades**

	Profitable % of Trades	Disparate Performance	Avg Built-In Profit	Disparate Performance
Favored Accounts	55.4%	9.2%	4.6%	6.5%
Aletheia Accounts	55.5%	9.3%	4.0%	5.9%
Custom Accounts	55.2%	9.0%	2.9%	4.7%
Eichler Accounts	53.5%	7.3%	6.5%	8.4%
Employee Accounts	70.0%	23.8%	9.2%	11.0%
Hedge Funds	29.3%	-16.9%	-6.7%	-4.9%
<b>Grand Total</b>	<b>46.2%</b>		<b>-1.9%</b>	

35. As described above, the Z Score and associated statistical confidence level measure the likelihood that the Disparate Performance is not the result of mere coincidental allocation of the Late Allocated Trades, but is reflective of some design. The following table sets forth the statistical level of confidence with which the Favored Accounts' Late Allocated Trades outperformed (and the Hedge Funds' Late Allocated Trades underperformed) a random allocation of the Late Allocated Trades.

**Figure 7:**

**Disparate Performance Among Late Allocated Trades**

	Profitable % of Trades		Average Built-In Profit	
	ZScores	Confidence	ZScores	Confidence
Favored Accounts	8.08	>99.99%	15.44	>99.99%
Aletheia Accounts	2.64	99.59%	4.52	>99.99%
Custom Accounts	5.63	>99.99%	7.97	>99.99%
Eichler Accounts	3.84	>99.99%	11.86	>99.99%
Employee Accounts	4.53	>99.99%	5.70	>99.99%
Hedge Funds	-10.99	>99.99%	-8.68	>99.99%

36. These results indicate that the Late Allocated Trades were not randomly allocated among accounts. For example, as above, with greater than 99.99% statistical confidence, random allocation did not account for the Eichler Accounts having received (a) a higher proportion of winning (versus losing) trades and (b) higher embedded profit than were they allocated a random sample of Late Allocated Trades. Conversely, with greater than 99.99% statistical confidence, randomness did not cause the Hedge Funds to receive (a) a lower proportion of winning (versus losing) trades and (b) lower returns than were they allocated a random sample of Late Allocated Trades.
37. The Disparate Performance benefited the Favored Accounts at the expense of the Hedge Funds. The following table sets forth the incremental built-in profit or loss allocated to each account class as a result of the actual allocations of the Late Allocated Trades compared to a random allocation of the same funds into the those same trades.

**Figure 8:**

**Incremental Profit Earned or Lost Relative to All Late Allocated Trades**

	Avg Built-In Profit			Late Allocated Trades \$ Invested	Incremental Profit		
	Late Allocated	All Late Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	4.6%	-1.9%	6.5%	\$49,868,697	\$3,205,931	\$2,722,272	\$2,584,852
Aletheia Accounts	4.0%	-1.9%	5.9%	\$5,514,590	\$320,389	\$227,803	\$201,304
Custom Accounts	2.9%	-1.9%	4.7%	\$23,166,587	\$1,077,645	\$898,485	\$847,805
Eichler Accounts	6.5%	-1.9%	8.4%	\$20,101,504	\$1,682,376	\$1,497,556	\$1,445,094
Employee Accounts	9.2%	-1.9%	11.0%	\$1,086,016	\$125,521	\$98,429	\$90,649
Hedge Funds	-6.7%	-1.9%	-4.9%	\$65,967,184	(\$3,205,931)	(\$2,742,531)	(\$2,605,420)

38. The above analysis suggests the Favored Accounts likely benefited by an incremental built-in profit of \$3.2 million while the Hedge Funds likely suffered an incremental built-in loss of like amount as a result of the Disparate Performance. Indeed, with 95% statistical confidence, the Favored Accounts benefited by an incremental built-in profit of **at least** \$2.6 million and the Hedge Funds suffered a corresponding incremental built-in loss as a result of non-random allocation.



**VI. Perfect Information Trades Inappropriately Diverted Guaranteed Profit to the Favored Accounts**

39. Perfect Information Trades cannot be expected to reflect any investment strategy return; by definition, at the time of allocation these “trades” were simply realized profit and loss amounts.<sup>15</sup>
40. As the table below demonstrates, not only did the Favored Accounts profit on 98% of Perfect Information Trades allocated to them (compared to just 41% for the Hedge Funds), but the profit granted to the Favored Accounts exceeded the entire net profit from all Perfect Information Trades. By contrast, the Hedge Funds suffered a net loss; not only did the Defendants not share the profits with the Hedge Funds, but the Hedge Funds actually paid for the Favored Accounts to obtain such profit.

**Figure 9:**

**Perfect Information Trade Performance by Account**

	Profitable % of Trades	Net Profit	% of Net Profit
Favored Accounts	98.1%	\$2,259,826	105.0%
Aletheia Accounts	100%	\$254,390	11.8%
Custom Accounts	97.0%	\$848,106	39.4%
Eichler Accounts	98.5%	\$1,068,638	49.7%
Employee Accounts	100%	\$88,692	4.1%
Hedge Funds	41.4%	(\$108,306)	-5.0%
<b>Grand Total</b>	<b>91.3%</b>	<b>\$2,151,520</b>	<b>100%</b>

41. Aletheia’s compliance policies during at least some part of the Relevant Period appear to prohibit some or all of the Favored Accounts from engaging in short-term trading, such as the Perfect Information Trades.<sup>16</sup> Notwithstanding that Perfect Information Trades should ideally have been allocated on a timely basis, the Perfect Information Trades represent guaranteed profit and should have been distributed fairly and equitably to Aletheia’s clients.<sup>17</sup> As such, the \$2.3 million of guaranteed profit allocated to the Favored Accounts should properly have been allocated to unrelated client accounts.
42. Assuming, *arguendo*, that all of the Favored Accounts were authorized to transact in trades such as the Perfect Information Trades and that none of the Favored Accounts was obligated to act in the best interests of Aletheia’s clients, the guaranteed profit of the Perfect

<sup>15</sup> See Murray Report at 9

<sup>16</sup> See Murray Report ¶94

<sup>17</sup> See Murray Report ¶108

Information Trades should have been allocated among the accounts based on an appropriate measure of capital available for options trading.<sup>18</sup>

43. While it is difficult to determine each account class' capital available for options trading, options transaction volume provides a proxy for such capital. As the table below demonstrates, **the guaranteed profit and loss associated with the Perfect Information Trades was allocated in a manner wholly inconsistent with capital deployed in options trading.**

**Figure 10:**

	Incremental Profit Earned or Lost on Perfect Information Trades						
	All Options Excluding Perfect Information		Perfect Information Trades		Incremental Profit		
	\$ Invested	% of Total	Net Profit	% of Total	Average	90% Confidence	95% Confidence
Favored Accounts	\$51,502,380	23.0%	\$2,259,826	105.0%	\$1,764,363	\$1,661,957	\$1,632,355
Aletheia Accounts	\$5,076,288	2.3%	\$254,390	11.8%	\$205,555	\$186,892	\$181,497
Custom Accounts	\$24,048,473	10.8%	\$848,106	39.4%	\$616,755	\$577,936	\$566,715
Eichler Accounts	\$21,458,016	9.6%	\$1,068,638	49.7%	\$862,208	\$825,302	\$814,634
Employee Accounts	\$919,603	0.4%	\$88,692	4.1%	\$79,845	\$71,826	\$69,508
Hedge Funds	\$172,143,812	77.0%	(\$108,306)	-5.0%	(\$1,764,363)	(\$1,711,606)	(\$1,696,356)
<b>Grand Total</b>	<b>\$223,646,192</b>	<b>100%</b>	<b>\$2,151,520</b>	<b>100%</b>			

44. The above analysis suggests the Favored Accounts likely benefited by an incremental guaranteed profit of \$1.8 million while the Hedge Funds likely forewent an incremental guaranteed profit of like amount as a result of the allocation of Perfect Information Trades. At the 95% confidence level, the incremental benefit to the Favored Accounts is **at least** \$1.6 million and harm to the Hedge Funds is **at least** \$1.7 million compared to a random allocation of Perfect Information Trades based on trading volume.
45. The incremental profit and loss derived from Perfect Information Trades is not additive to the analyses presented above in Sections IV and V of this Report. Rather, the incremental profit and loss derived from Perfect Information Trades is a subset of the incremental profit and loss derived from all Late Allocated Trades.

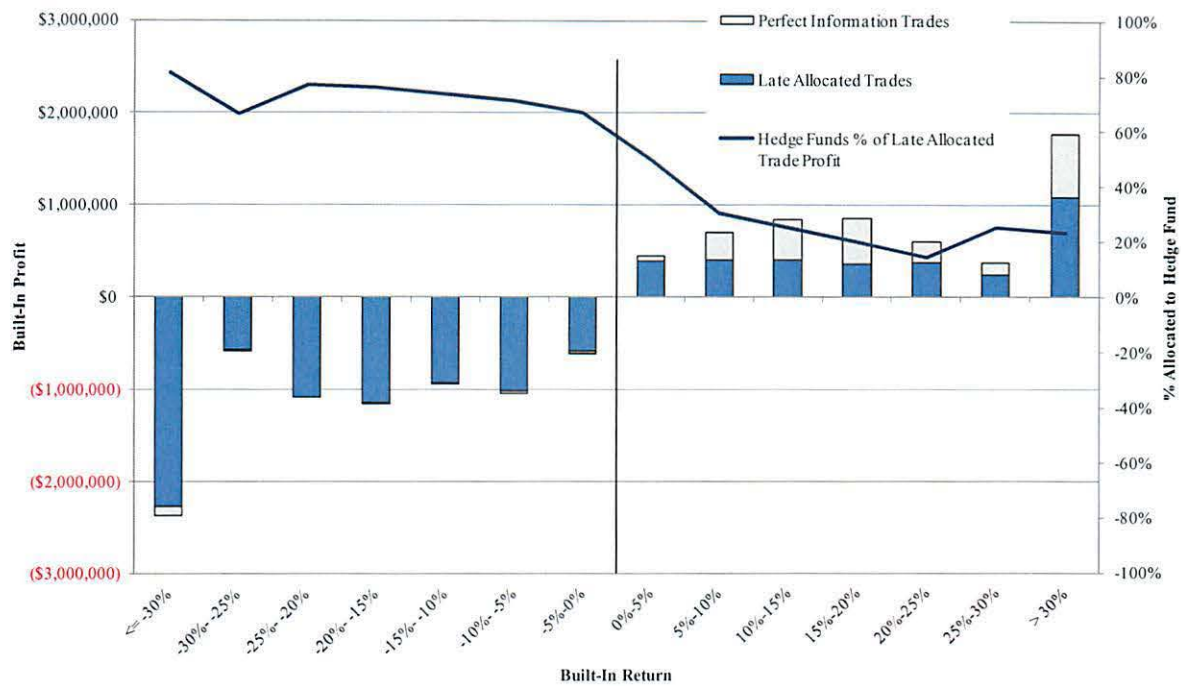
<sup>18</sup> See Murray Report ¶41

**VII. A Late Allocated Trade's Built-In Return is a Strong Predictor of the Account Class to which its Profit will be Allocated**

46. As illustrated below, the Late Allocated Trades with the greatest losses were most often allocated to the Hedge Funds, whereas more profitable Late Allocated Trades were most often allocated to the Favored Accounts. Indeed, the most profitable Late Allocated Trades were frequently granted to the Favored Accounts as guaranteed profit Perfect Information Trades.

**Figure 11:**

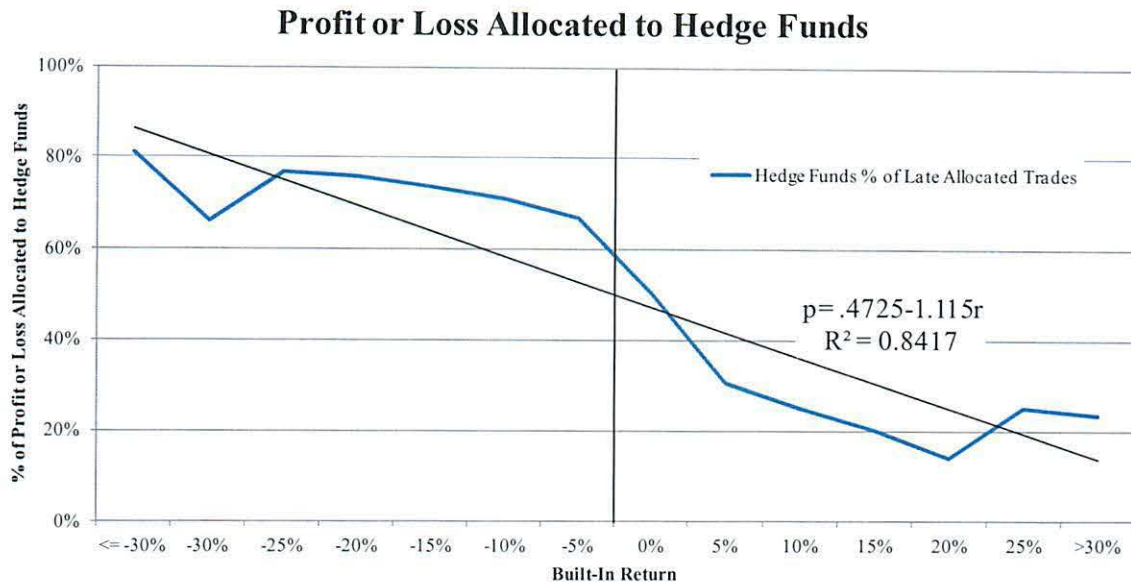
**Late Allocated and Perfect Information Trades by Built-In Return**



47. The level of built-in return on given Late Allocated Trades predicts, with a high degree of predictive power, the probability that the associated profit or loss was allocated to the Hedge Funds (instead of the Favored Accounts). In other words, the amount of return on a Late Allocated Trade explains with 84% accuracy the actual allocation of profit or loss associated with such a trade.



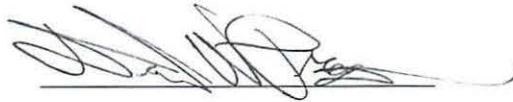
**Figure 12:**



48. The regression above demonstrates that when investment returns on given Late Allocated Trades *increase* 10%, the probability that the associated profit will be allocated to the Hedge Funds *declines* by 11.2%. The regression analysis also suggests, for example, that 70% of the loss associated with trades that were *down* 20% at the time of allocation would be allocated to the Hedge Funds. By contrast, for trades that were *up* 20% at the time of allocation only 25% of the associated profit would be allocated to the Hedge Funds.
49. As noted above, this regression is quite powerful in explaining the probability that profit or losses would be allocated to the Hedge Funds, explaining 84.2% of such allocation. Additionally, it is clear, with 99.99% statistical significance, that **increased built-in returns were a predominant factor in determining to allocate the Late Allocated Trades to the Favored Accounts.**

VIII. Signature

50. My work on this case is continuing. I reserve the right to revise or augment the findings and opinions set forth herein in the event additional information relevant to the issues I have examined becomes available, in response to questions raised in deposition or for other reasons.

A handwritten signature in black ink, appearing to read 'David W. Prager', written over a horizontal line.

David W. Prager

## Appendix I—Sensitivity Analysis

### Comparison of Late Allocated Trade Performance to Timely Allocated Trade Performance

#### 15 Minute Cutoff

	Number of Trades		End of Day Return				
	Late Allocated	Timely Allocated	Late Allocated	Timely Allocated	Disparate Performance	Z Scores	Confidence
Favored Accounts	2,212	706	3.9%	-3.8%	7.7%	13.93	>99.99%
Aletheia Accounts	223	43	3.6%	-1.9%	5.4%	2.67	99.62%
Custom Accounts	1,094	286	1.9%	-3.8%	5.7%	8.37	>99.99%
Eichler Accounts	771	234	6.1%	-4.2%	10.3%	9.32	>99.99%
Employee Accounts	124	143	8.6%	-3.1%	11.7%	6.74	>99.99%
Hedge Funds	1,284	730	-5.8%	-2.1%	-3.8%	-7.04	>99.99%

#### 1 Hour Cutoff

	Number of Trades		End of Day Return				
	Late Allocated	Timely Allocated	Late Allocated	Timely Allocated	Disparate Performance	Z Scores	Confidence
Favored Accounts	1,933	985	4.7%	-3.7%	8.3%	15.01	>99.99%
Aletheia Accounts	200	66	4.0%	-1.5%	5.5%	2.80	99.74%
Custom Accounts	965	415	2.7%	-4.4%	7.1%	10.86	>99.99%
Eichler Accounts	678	327	6.9%	-3.2%	10.1%	9.10	>99.99%
Employee Accounts	90	177	9.4%	-3.6%	12.9%	6.51	>99.99%
Hedge Funds	1,069	945	-6.6%	-2.1%	-4.5%	-7.59	>99.99%

#### 2 Hour Cutoff

	Number of Trades		End of Day Return				
	Late Allocated	Timely Allocated	Late Allocated	Timely Allocated	Disparate Performance	Z Scores	Confidence
Favored Accounts	1,771	1,147	5.2%	-3.3%	8.5%	14.91	>99.99%
Aletheia Accounts	190	76	4.2%	-1.1%	5.3%	2.68	99.63%
Custom Accounts	893	487	2.9%	-3.9%	6.8%	10.31	>99.99%
Eichler Accounts	605	400	8.0%	-3.0%	11.0%	9.66	>99.99%
Employee Accounts	83	184	9.7%	-3.3%	13.1%	6.28	>99.99%
Hedge Funds	941	1,073	-7.1%	-2.2%	-4.9%	-7.61	>99.99%

#### Market Close Cutoff

	Number of Trades		End of Day Return				
	Late Allocated	Timely Allocated	Late Allocated	Timely Allocated	Disparate Performance	Z Scores	Confidence
Favored Accounts	1,845	1,073	4.4%	-1.7%	6.1%	9.41	>99.99%
Aletheia Accounts	196	70	3.9%	-0.8%	4.7%	2.02	97.83%
Custom Accounts	945	435	2.6%	-4.1%	6.7%	9.05	>99.99%
Eichler Accounts	621	384	6.4%	0.4%	6.0%	4.61	>99.99%
Employee Accounts	83	184	9.8%	-2.8%	12.6%	6.00	>99.99%
Hedge Funds	982	1,032	-6.3%	-2.4%	-3.8%	-6.31	>99.99%



## Incremental Profit Earned or Lost Relative to Timely Allocated Trades

### 15 Minute Cutoff

	Avg Return			Late Allocated Trades \$ Invested	Incremental Profit		
	Late Allocated	Timely Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	3.9%	-3.8%	7.7%	\$55,072,482	\$4,223,659	\$3,501,280	\$3,292,468
Aletheia Accounts	3.6%	-1.9%	5.4%	\$6,028,349	\$328,055	\$170,500	\$124,957
Custom Accounts	1.9%	-3.8%	5.7%	\$25,660,942	\$1,460,432	\$1,236,965	\$1,172,369
Eichler Accounts	6.1%	-4.2%	10.3%	\$22,240,278	\$2,301,059	\$1,985,169	\$1,893,857
Employee Accounts	8.6%	-3.1%	11.7%	\$1,142,913	\$134,112	\$108,646	\$101,285
Hedge Funds	-5.8%	-2.1%	-3.8%	\$80,259,649	(\$3,041,936)	(\$2,488,478)	(\$2,328,495)

### 1 Hour Cutoff

	Avg Return			Late Allocated Trades \$ Invested	Incremental Profit		
	Late Allocated	Timely Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	4.7%	-3.7%	8.3%	\$49,868,697	\$4,109,645	\$3,465,659	\$3,279,507
Aletheia Accounts	4.0%	-1.5%	5.5%	\$5,514,590	\$302,214	\$163,986	\$124,030
Custom Accounts	2.7%	-4.4%	7.1%	\$23,166,587	\$1,644,373	\$1,450,636	\$1,394,634
Eichler Accounts	6.9%	-3.2%	10.1%	\$20,101,504	\$2,022,500	\$1,738,125	\$1,655,923
Employee Accounts	9.4%	-3.6%	12.9%	\$1,086,016	\$140,559	\$112,912	\$104,921
Hedge Funds	-6.6%	-2.1%	-4.5%	\$65,967,184	(\$2,954,106)	(\$2,456,223)	(\$2,312,303)

### 2 Hour Cutoff

	Avg Return			Late Allocated Trades \$ Invested	Incremental Profit		
	Late Allocated	Timely Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	5.2%	-3.3%	8.5%	\$46,083,759	\$3,890,488	\$3,282,010	\$3,106,122
Aletheia Accounts	4.2%	-1.1%	5.3%	\$5,237,156	\$277,179	\$144,920	\$106,689
Custom Accounts	2.9%	-3.9%	6.8%	\$21,749,092	\$1,487,105	\$1,302,483	\$1,249,116
Eichler Accounts	8.0%	-3.0%	11.0%	\$18,048,324	\$1,989,183	\$1,725,524	\$1,649,310
Employee Accounts	9.7%	-3.3%	13.1%	\$1,049,187	\$137,020	\$109,083	\$101,007
Hedge Funds	-7.1%	-2.2%	-4.9%	\$57,753,342	(\$2,811,012)	(\$2,338,329)	(\$2,201,694)

### Market Close Cutoff

	Avg Return			Late Allocated Trades \$ Invested	Incremental Profit		
	Late Allocated	Timely Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	4.4%	-1.7%	6.1%	\$47,209,949	\$2,994,736	\$2,289,199	\$2,085,255
Aletheia Accounts	3.9%	-0.8%	4.7%	\$5,446,293	\$255,857	\$93,921	\$47,112
Custom Accounts	2.6%	-4.1%	6.7%	\$22,888,409	\$1,533,002	\$1,316,122	\$1,253,430
Eichler Accounts	6.4%	0.4%	6.0%	\$17,844,469	\$1,076,076	\$777,055	\$690,620
Employee Accounts	9.8%	-2.8%	12.6%	\$1,030,778	\$129,802	\$102,101	\$94,094
Hedge Funds	-6.3%	-2.4%	-3.8%	\$61,589,216	(\$2,351,467)	(\$1,874,143)	(\$1,736,167)

## Comparison of Account Late Allocated Trades to All Late Allocated Trades

### 15 Minute Cutoff

	Number of Late Allocated Trades	Avg Built-In Profit	Disparate Performance	Z Scores	Confidence
Favored Accounts	2,212	4.0%	5.8%	16.04	>99.99%
Aletheia Accounts	223	3.6%	5.4%	4.71	>99.99%
Custom Accounts	1,094	2.3%	4.1%	8.02	>99.99%
Eichler Accounts	771	5.8%	7.7%	12.43	>99.99%
Employee Accounts	124	8.6%	10.4%	6.79	>99.99%
Hedge Funds	1,284	-5.8%	-4.0%	-8.38	>99.99%
<b>Grand Total</b>	<b>3,496</b>	<b>-1.8%</b>			

### 1 Hour Cutoff

	Number of Late Allocated Trades	Avg Built-In Profit	Disparate Performance	Z Scores	Confidence
Favored Accounts	1,933	4.6%	6.5%	15.44	>99.99%
Aletheia Accounts	200	4.0%	5.9%	4.52	>99.99%
Custom Accounts	965	2.9%	4.7%	7.97	>99.99%
Eichler Accounts	678	6.5%	8.4%	11.86	>99.99%
Employee Accounts	90	9.2%	11.0%	5.70	>99.99%
Hedge Funds	1,069	-6.7%	-4.9%	-8.68	>99.99%
<b>Grand Total</b>	<b>3,002</b>	<b>-1.9%</b>			

### 2 Hour Cutoff

	Number of Late Allocated Trades	Avg Built-In Profit	Disparate Performance	Z Scores	Confidence
Favored Accounts	1,771	5.1%	6.9%	15.03	>99.99%
Aletheia Accounts	190	4.2%	5.9%	4.27	>99.99%
Custom Accounts	893	3.1%	4.8%	7.53	>99.99%
Eichler Accounts	605	7.5%	9.3%	11.91	>99.99%
Employee Accounts	83	9.5%	11.3%	5.36	>99.99%
Hedge Funds	941	-7.2%	-5.5%	-8.74	>99.99%
<b>Grand Total</b>	<b>2,712</b>	<b>-1.8%</b>			

### Market Close Cutoff

	Number of Late Allocated Trades	Avg Built-In Profit	Disparate Performance	Z Scores	Confidence
Favored Accounts	1,845	4.4%	6.2%	14.65	>99.99%
Aletheia Accounts	196	4.0%	5.8%	4.47	>99.99%
Custom Accounts	945	2.8%	4.6%	7.88	>99.99%
Eichler Accounts	621	6.1%	7.9%	10.95	>99.99%
Employee Accounts	83	9.6%	11.3%	5.73	>99.99%
Hedge Funds	982	-6.5%	-4.7%	-8.19	>99.99%
<b>Grand Total</b>	<b>2,827</b>	<b>-1.8%</b>			



## Incremental Profit Earned or Lost Relative to All Late Allocated Trades

### 15 Minute Cutoff

	Avg Built-In Profit			Late Allocated Trades \$ Invested	Incremental Profit		
	Account Late Allocated	All Late Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	4.0%	-1.8%	5.8%	\$55,072,482	\$3,213,132	\$2,756,882	\$2,624,998
Aletheia Accounts	3.6%	-1.8%	5.4%	\$6,028,349	\$325,456	\$237,039	\$211,481
Custom Accounts	2.3%	-1.8%	4.1%	\$25,660,942	\$1,064,735	\$894,811	\$845,693
Eichler Accounts	5.8%	-1.8%	7.7%	\$22,240,278	\$1,703,697	\$1,528,268	\$1,477,558
Employee Accounts	8.6%	-1.8%	10.4%	\$1,142,913	\$119,244	\$96,765	\$90,267
Hedge Funds	-5.8%	-1.8%	-4.0%	\$80,259,649	(\$3,213,132)	(\$2,722,558)	(\$2,580,752)

### 1 Hour Cutoff

	Avg Built-In Profit			Late Allocated Trades \$ Invested	Incremental Profit		
	Account Late Allocated	All Late Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	4.6%	-1.9%	6.5%	\$49,868,697	\$3,205,931	\$2,722,272	\$2,584,852
Aletheia Accounts	4.0%	-1.9%	5.9%	\$5,514,590	\$320,389	\$227,803	\$201,304
Custom Accounts	2.9%	-1.9%	4.7%	\$23,166,587	\$1,077,645	\$898,485	\$847,805
Eichler Accounts	6.5%	-1.9%	8.4%	\$20,101,504	\$1,682,376	\$1,497,556	\$1,445,094
Employee Accounts	9.2%	-1.9%	11.0%	\$1,086,016	\$125,521	\$98,429	\$90,649
Hedge Funds	-6.7%	-1.9%	-4.9%	\$65,967,184	(\$3,205,931)	(\$2,742,531)	(\$2,605,420)

### 2 Hour Cutoff

	Avg Built-In Profit			Late Allocated Trades \$ Invested	Incremental Profit		
	Account Late Allocated	All Late Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	5.1%	-1.8%	6.9%	\$46,083,759	\$3,159,323	\$2,678,623	\$2,539,671
Aletheia Accounts	4.2%	-1.8%	5.9%	\$5,237,156	\$311,454	\$218,113	\$191,132
Custom Accounts	3.1%	-1.8%	4.8%	\$21,749,092	\$1,052,189	\$873,388	\$821,704
Eichler Accounts	7.5%	-1.8%	9.3%	\$18,048,324	\$1,677,256	\$1,496,991	\$1,444,883
Employee Accounts	9.5%	-1.8%	11.3%	\$1,049,187	\$118,423	\$90,131	\$81,952
Hedge Funds	-7.2%	-1.8%	-5.5%	\$57,753,342	(\$3,159,323)	(\$2,696,797)	(\$2,563,098)

### Market Close Cutoff

	Avg Built-In Profit			Late Allocated Trades \$ Invested	Incremental Profit		
	Account Late Allocated	All Late Allocated	Disparate Performance		Average	90% Confidence	95% Confidence
Favored Accounts	4.4%	-1.8%	6.2%	\$47,209,949	\$2,905,781	\$2,452,391	\$2,321,333
Aletheia Accounts	4.0%	-1.8%	5.8%	\$5,446,293	\$313,979	\$224,118	\$198,143
Custom Accounts	2.8%	-1.8%	4.6%	\$22,888,409	\$1,059,209	\$887,222	\$837,507
Eichler Accounts	6.1%	-1.8%	7.9%	\$17,844,469	\$1,415,608	\$1,250,201	\$1,202,388
Employee Accounts	9.6%	-1.8%	11.3%	\$1,030,778	\$116,985	\$90,850	\$83,296
Hedge Funds	-6.5%	-1.8%	-4.7%	\$61,589,216	(\$2,905,781)	(\$2,451,792)	(\$2,320,561)

## Appendix 2—Statistical Techniques Employed

### Z Test

Much of the analysis in this Report seeks to determine whether the performance of one set of trades differed significantly from the performance of another set of trades.

Analysis of this type is commonly performed using a technique called hypothesis testing. A common technique for measuring the significance of the perceived differences in data sets is the “Z Test.”<sup>19</sup> The Z Test can be used to determine either (i) whether the set of data is a random subset of a larger group or “population” or (ii) whether two sets of data are subsets of the same population.<sup>20</sup> Although the Z Test assumes that observed results will follow a pattern known as a “normal distribution,”<sup>21</sup> the Central Limit Theorem posits that given a sufficiently large sample (more than approximately 30 observations), the average of samples from any population will follow a normal distribution<sup>22</sup> and, accordingly, the Z Test may be utilized.<sup>23</sup>

Pursuant to the Z Test, the significance of variation in summary performance of two data sets (e.g., average performance, percentage of winners) is determined by reference to (i) the difference in the average performance between the data sets and (ii) the degree to which underlying individual observations within each data set deviate from that average.

As described below, the Z Test calculates a “Z Score” as the ratio of (a) the difference between the average of the observed data and the assumed performance (be that the performance of the larger group from which the data was selected or the performance of an alternative sample) to (b) the standard error (a measure of variability in observations) of the data (calculated either based on the variability of the performance of the population or the variability of the sampled data).

Tests concerned with one mean are used when testing whether the performance of a sample set is consistent with the performance of a larger group (known as the “population”) from which the sample was selected (e.g., whether Late Allocated Trades in one account class were a random sample of all Late Allocated Trades). In this case, the Z Score is defined as follows:<sup>24</sup>

$$Z = \frac{\bar{X} - \mu}{\frac{\sigma}{\sqrt{n}}} \text{ where:}$$

$\bar{X} - \mu$  is the difference between the performance of the sample observations and the larger population and

$\frac{\sigma}{\sqrt{n}}$  is the standard error of the population.

<sup>19</sup> See Mark L. Berenson, *et al*, *Basic Business Statistics: Concepts and Applications* at 301 (9<sup>th</sup> ed. 2004); Richard A. DeFusco, *et al*, *Quantitative Methods for Investment Analysis* at 257-8 (2<sup>nd</sup> ed. 2007)

<sup>20</sup> See DeFusco, *supra* at 254, 261; Berenson *supra* at 301, 336

<sup>21</sup> See DeFusco, *supra* at 258; Berenson *supra* at 337

<sup>22</sup> See DeFusco, *supra* at 254; Berenson *supra* at 239

<sup>23</sup> See DeFusco, *supra* at 257; Berenson *supra* at 336

<sup>24</sup> See DeFusco, *supra* at 258; Berenson *supra* at 301



Tests concerning the difference between means are used when comparing whether two data sets are samples of the same larger population and, therefore, reflect the same performance (e.g., whether an account's Late Allocated Trades performed in a manner consistent with that account's Timely Allocated Trades). In this case, the Z Score is defined as follows:<sup>25</sup>

$$Z = \frac{(\bar{X}_1 - \bar{X}_2) - (\mu_1 - \mu_2)}{\sqrt{\frac{\sigma_1^2}{n_1} + \frac{\sigma_2^2}{n_2}}} \text{ where:}$$

$(\bar{X}_1 - \bar{X}_2)$  is the observed difference in performance between the data sets

$\mu_1 - \mu_2$  is the hypothesized difference in performance between the data sets (i.e., zero when testing that the performance is equal) and

$\sqrt{\frac{\sigma_1^2}{n_1} + \frac{\sigma_2^2}{n_2}}$  is the square root of the sum of the squares of the standard errors of the two data sets.

Higher absolute value Z Scores will indicate greater confidence that the two data sets were not randomly observed from of the same general population.<sup>26</sup> In other words, confidence that average performance truly differs increases as (a) the observed difference in results increases and (b) the dispersion in results within the observed samples decreases. Take, for example, the following data sets:

	A	B	C
<b>Average Return</b>	5%	5.25%	20%
<b>Observed Returns</b>	Evenly distributed 4% to 6%	Evenly distributed 0% to 10.5%	Evenly distributed 19% to 21%

Data Sets A and B are relatively likely to be samples from the same population as the average returns are relatively close and the dispersion of results is relative large. Data Sets A and C are relatively unlikely to be samples from the same population as the average returns are relatively diverse and the dispersion of results is relative small.

The Z Test establishes the level of significance (or confidence) of any observed Z Score by reference to the "Z Score Table," a copy of which is included below. The Z Test can be used to test whether one data set comes from a pool of **higher** observed values than the other data set (a one-sided test) or whether the two data sets come from **different** underlying pools without regard to direction (a two-sided test).<sup>27</sup> The analysis presented herein utilizes one-side tests.

<sup>25</sup> See Berenson *supra* at 336

<sup>26</sup> See DeFusco, *supra* at 250-2; Berenson *supra* at 302

<sup>27</sup> See DeFusco, *supra* at 245

Confidence levels of 90% or higher are generally considered to be reliable.<sup>28</sup> For a one-sided Z Test, a Z score of 1.28 indicates 90% confidence. Z scores of 1.64 and 2.32 reflect confidence levels of 95% and 99%, respectively.

### Z Score--One-sided Probability

z	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.0	0.5000	0.5040	0.5080	0.5120	0.5160	0.5199	0.5239	0.5279	0.5319	0.5359
0.1	0.5398	0.5438	0.5478	0.5517	0.5557	0.5596	0.5636	0.5675	0.5714	0.5753
0.2	0.5793	0.5832	0.5871	0.5910	0.5948	0.5987	0.6026	0.6064	0.6103	0.6141
0.3	0.6179	0.6217	0.6255	0.6293	0.6331	0.6368	0.6406	0.6443	0.6480	0.6517
0.4	0.6554	0.6591	0.6628	0.6664	0.6700	0.6736	0.6772	0.6808	0.6844	0.6879
0.5	0.6915	0.6950	0.6985	0.7019	0.7054	0.7088	0.7123	0.7157	0.7190	0.7224
0.6	0.7257	0.7291	0.7324	0.7357	0.7389	0.7422	0.7454	0.7486	0.7517	0.7549
0.7	0.7580	0.7611	0.7642	0.7673	0.7704	0.7734	0.7764	0.7794	0.7823	0.7852
0.8	0.7881	0.7910	0.7939	0.7967	0.7995	0.8023	0.8051	0.8078	0.8106	0.8133
0.9	0.8159	0.8186	0.8212	0.8238	0.8264	0.8289	0.8315	0.8340	0.8365	0.8389
1.0	0.8413	0.8438	0.8461	0.8485	0.8508	0.8531	0.8554	0.8577	0.8599	0.8621
1.1	0.8643	0.8665	0.8686	0.8708	0.8729	0.8749	0.8770	0.8790	0.8810	0.8830
1.2	0.8849	0.8869	0.8888	0.8907	0.8925	0.8944	0.8962	0.8980	0.8997	0.9015
1.3	0.9032	0.9049	0.9066	0.9082	0.9099	0.9115	0.9131	0.9147	0.9162	0.9177
1.4	0.9192	0.9207	0.9222	0.9236	0.9251	0.9265	0.9279	0.9292	0.9306	0.9319
1.5	0.9332	0.9345	0.9357	0.9370	0.9382	0.9394	0.9406	0.9418	0.9429	0.9441
1.6	0.9452	0.9463	0.9474	0.9484	0.9495	0.9505	0.9515	0.9525	0.9535	0.9545
1.7	0.9554	0.9564	0.9573	0.9582	0.9591	0.9599	0.9608	0.9616	0.9625	0.9633
1.8	0.9641	0.9649	0.9656	0.9664	0.9671	0.9678	0.9686	0.9693	0.9699	0.9706
1.9	0.9713	0.9719	0.9726	0.9732	0.9738	0.9744	0.9750	0.9756	0.9761	0.9767
2.0	0.9772	0.9778	0.9783	0.9788	0.9793	0.9798	0.9803	0.9808	0.9812	0.9817
2.1	0.9821	0.9826	0.9830	0.9834	0.9838	0.9842	0.9846	0.9850	0.9854	0.9857
2.2	0.9861	0.9864	0.9868	0.9871	0.9875	0.9878	0.9881	0.9884	0.9887	0.9890
2.3	0.9893	0.9896	0.9898	0.9901	0.9904	0.9906	0.9909	0.9911	0.9913	0.9916
2.4	0.9918	0.9920	0.9922	0.9925	0.9927	0.9929	0.9931	0.9932	0.9934	0.9936
2.5	0.9938	0.9940	0.9941	0.9943	0.9945	0.9946	0.9948	0.9949	0.9951	0.9952
2.6	0.9953	0.9955	0.9956	0.9957	0.9959	0.9960	0.9961	0.9962	0.9963	0.9964
2.7	0.9965	0.9966	0.9967	0.9968	0.9969	0.9970	0.9971	0.9972	0.9973	0.9974
2.8	0.9974	0.9975	0.9976	0.9977	0.9977	0.9978	0.9979	0.9979	0.9980	0.9981
2.9	0.9981	0.9982	0.9982	0.9983	0.9984	0.9984	0.9985	0.9985	0.9986	0.9986
3.0	0.9987	0.9987	0.9987	0.9988	0.9988	0.9989	0.9989	0.9989	0.9990	0.9990
3.1	0.9990	0.9991	0.9991	0.9991	0.9992	0.9992	0.9992	0.9992	0.9993	0.9993
3.2	0.9993	0.9993	0.9994	0.9994	0.9994	0.9994	0.9994	0.9995	0.9995	0.9995
3.3	0.9995	0.9995	0.9995	0.9996	0.9996	0.9996	0.9996	0.9996	0.9996	0.9997
3.4	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9998

Table presents the cumulative probability associated with Z Score equal to the sum of the corresponding column and row labels.

### Linear Regression

Regression analysis determines the ability of one or more variables (the independent variables) to predict the outcome of another variable (the dependent variable).<sup>29</sup> For example, a linear

<sup>28</sup> See DeFusco, *supra* at 248

<sup>29</sup> See DeFusco, *supra* at 300; Berenson *supra* at 484



regression can be used to predict the probability that the profit from a Late Allocated Trade will be allocated to the Hedge Funds (dependent variable) based on the built-in return at the time of allocation (independent variable).

A linear regression is calculated to yield a line of “best fit,” which minimizes the sum of the squared differences between the actual observations and the regression line<sup>30</sup> as follows:<sup>31</sup>

$$Y_i = \alpha + \beta X_i + \varepsilon_i \text{ where:}$$

$Y$  is the dependent variable;

$X$  is the independent variable;

$\beta = \frac{\sigma_{X,Y}}{\sigma_X^2}$  is the regression coefficient<sup>32</sup> and calculates the extent to which  $X$  and  $Y$  move in tandem (specifically, the extent to which  $X$  and  $Y$  both move compared to movement in  $X$ ); and

$\varepsilon_i$  is the error term, the portion of the dependent variable that is not explained by the independent variable.

The explanatory power of the linear regression is evaluated by reference to the coefficient of determination, known as  $R^2$ , which represents the percentage of total variation in the independent variable that is explained by the regression.  $R^2$  is bounded by 0 and 1 with values closer to 1 indicating stronger predictive ability of the regression.<sup>33</sup>

The most common method of testing whether the apparent relationship between dependent and independent variables are the result of chance is the “t test,” which represents a modification of the Z test to reflect smaller sample size.<sup>34</sup> A higher absolute value of the t statistic corresponds to a higher degree of confidence in the relationship.

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<sup>30</sup> See DeFusco, *supra* at 301; Berenson *supra* at 488

<sup>31</sup> See DeFusco, *supra* at 300; Berenson *supra* at 485

<sup>32</sup> See DeFusco, *supra* at 302; Berenson *supra* at 523

<sup>33</sup> See DeFusco, *supra* at 309; Berenson *supra* at 496

<sup>34</sup> See DeFusco, *supra* at 331, 257; Berenson *supra* at 509-10

### Appendix 3—Sources of Data

The data used for the analyses in this Report was compiled and organized by my team at my direction and originated from Aletheia's trade blotters from National Financial Services, LLC, an affiliate of Fidelity Investments ("NFS") and Merrill Lynch & Co., Inc. ("Merrill Lynch"). The NFS blotters contained information about all Aletheia trades during the Relevant Period, while the Merrill Lynch blotters contained information about the Hedge Funds exclusively. The analysis herein considers only options trades. The original execution time reflected in the NFS blotters was utilized as the true execution time for all trades. The Hedge Funds' trades reflected on the NFS blotters contained duplicative rows which obscured whether a trade was a buy or a sell. The Merrill Lynch blotters, therefore, were utilized to determine the direction (buy or sell) of the Hedge Funds' trades. Trades executed in small lots were consolidated as one trade if the purchases were less than 10 minutes apart. Allocation time was determined by reference to the NFS blotters' "PNS Process Time" field.

Trades where the sell time occurred before the allocation time were flagged as Perfect Information Trades. Where a position was partially closed at the end of the day, the position was split into a day trade buy and open trade buy.

End-of-day options prices were sourced from OptionMetrics, LLC, a provider of historical option price data. For calculations of built-in profit or loss at the time of allocation, intra-day prices were calculated using linear interpolation between the purchase price and the end of day-of-allocation price.



## Exhibit A—Curriculum Vitae

### DAVID W. PRAGER

*David W. Prager is a Managing Director at Goldin Associates, LLC, where he has provided expert testimony, litigation support and interim management in major matters and advised companies and their creditors in both in- and out-of-court restructurings. Mr. Prager's practice has focused on complex financial matters and business problems, including the application of intricate financial modeling and analysis to corresponding business principles.*

*Mr. Prager is an experienced financial and restructuring professional who has provided litigation support in many matters respecting trading and investment management irregularities, complex structured products, complicated financial settlements and allocation of value. He has provided business and strategic guidance (including litigation support and testimony) and concomitant analytical support in major matters and advised debtors and creditors in numerous industries, including financial services, energy and power and media and telecommunications and has significant experience with structured financial products.*

- EXPERIENCE: Goldin Associates, L.L.C., 2002 to Present
- MBIA – consultant respecting fraudulent conveyance claims
  - The PMI Group – CEO and restructuring advisor
  - Syncora Guarantee – CFO and primary restructuring advisor
  - Tribune Company – expert at confirmation
  - Adelphia Communications –expert at confirmation
  - Enron North America – financial advisor to the Examiner
  - Confidential Investor – litigation consultant respecting investment guideline compliance
  - Confidential CDO Manager – litigation consultant respecting portfolio compliance
  - SemGroup – forensic financial advisor to creditors' committee
  - FGIC – financial advisor to credit default swap counterparties
  - MXEnergy – financial advisor to senior lenders
  - Loral Space & Communications – financial advisor to Examiner
  - NorthWestern Corp. – financial advisor to bondholders
- McManus & Miles Incorporated
- Investment bank concentrating on project finance in the power and energy sector
- PRIOR TESTIMONY:
- The PMI Group – fact witness at bankruptcy plan confirmation hearing
  - Tribune Company – expert at bankruptcy plan confirmation hearing (deposition)
- EDUCATION:
- Wharton School of the University of Pennsylvania (*B.S. in Economics*)
- OTHER:
- Chartered Financial Analyst (CFA)
  - New York Society of Securities Analysts
  - CFA Institute
  - American Bankruptcy Institute

## Exhibit B—Materials Considered

### Proceeding Documents:

- *S.E.C. v. Aletheia Research and Mgmt. Inc., et al.*, No. 12 Cir. 10692 (C.D. Cal.), Compl.
- *Wells Submission on Behalf of Aletheia Research and Management, Inc. and Peter J. Eichler, Jr.*, December 5, 2012
- *Deposition of Peter James Eichler, Jr.*, August 17, 2012
- *Deposition of Christine Wright Roper*, August 8, 2012
- *Deposition of Patricia Barnes*, August 15, 2012
- *Private Placement Memorandum Limited Partnership Interests in the Aletheia Insider Index*, March 1, 2006
- *Report of Marti P. Murray*, August 26, 2013

### Other:

- Richard A. DeFusco, Dennis W. McLeavey, Jerald E. Pinto, and David E. Runkle, *Quantitative Methods for Investment Analysis* (2<sup>nd</sup> ed. 2004)
- Mark L. Berenson, David M. Levine, and Timothy C. Krehbiel, *Basic Business Statistics: Concepts and Applications* (9<sup>th</sup> ed. 2004)
- Aletheia Insider Index LP Merrill Lynch Trade Blotter (Exhibit A-Trade Blotter 520-64315-D2.xlsx)
- Aletheia Insider Index II LP Merrill Lynch Trade Blotter (Exhibit B Trade Blotter 520-63315-D3.xlsx)
- Aletheia NFS Trade Blotters (NFS January 2009.xlsx – NFS November 2011.xlsx)
- OptionMetrics pricing (file\_18\_opt\_metrics\_data\_adj.xlsx)

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES -- GENERAL

Case No. **CV 12-10692-JFW (RZx)**

Date: May 11, 2015

Title: Securities and Exchange Commission -v- Aletheia Research and Management Inc., et al.

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**PRESENT:**

**HONORABLE JOHN F. WALTER, UNITED STATES DISTRICT JUDGE**

**Shannon Reilly  
Courtroom Deputy**

**None Present  
Court Reporter**

**ATTORNEYS PRESENT FOR PLAINTIFFS:**

None

**ATTORNEYS PRESENT FOR DEFENDANTS:**

None

**PROCEEDINGS (IN CHAMBERS):**

**ORDER GRANTING PLAINTIFF SECURITIES AND  
EXCHANGE COMMISSION'S MOTION FOR  
MONETARY REMEDIES AGAINST DEFENDANT  
PETER J. EICHLER, JR. [filed 4/2/2015; Docket No. 64]**

On April 2, 2015, Plaintiff Securities and Exchange Commission (the "SEC") filed a Motion for Monetary Remedies Against Defendant Peter J. Eichler, relying on its Memoranda of Points and Authorities and the Declaration and Exhibits thereto, filed on January 27, 2014 [Docket No. 44] and the Reply in Support of the SEC's Remedies Motion and the Supplemental Declaration of Gary Y. Yeung and Exhibits thereto, filed on February 18, 2014 [Docket No. 47]. On April 10, 2015, Defendant Peter J. Eichler filed his Opposition, relying on the Declaration of Peter J. Eichler, Declaration of Dr. Faten Sabry, and Declaration of Estela Diaz, and the Exhibits thereto, filed on February 10, 2014 [Docket Nos. 45-1 to 45-16]. Pursuant to Rule 78 of the Federal Rules of Civil Procedure and Local Rule 7-15, the Court found the matter appropriate for submission on the papers without oral argument. The matter was, therefore, removed from the Court's May 4, 2015 hearing calendar and the parties were given advance notice. After considering the moving, opposing, and reply papers, and the arguments therein, the Court rules as follows:

**I. FACTUAL AND PROCEDURAL BACKGROUND<sup>1</sup>**

This SEC enforcement action concerns a "cherry-picking" scheme by Defendant Peter J. Eichler, Jr. ("Eichler"). "Cherry-picking" is the practice of allocating winning trades to favored accounts, and conversely, allocating losing trades to disfavored accounts. When a trade remains

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<sup>1</sup>Pursuant to the Consent of Peter J. Eichler [Docket No. 31-1] and the November 7, 2013 Judgment as to Defendant Peter J. Eichler, Jr. [Docket No. 32], the Court accepts and deems the allegations of the SEC's Complaint as true solely for the purposes of this motion.

unallocated following trade execution, the passage of time makes that trade increasingly susceptible to cherry picking. Post-execution movements in price permit an investment adviser to make allocation decisions at a time when the trade has a known mark-to-market profit or loss.

Eichler was the chairman, chief executive officer and chief investment officer of Defendant Aletheia Research and Management, Inc. ("Aletheia") and was personally responsible for each and every investment decision made by Aletheia during the relevant period. Eichler delayed allocating trades until the economics of the investment were known, and then allocated winning trades to favored accounts, including his own, and allocated losing trades to two disfavored hedge funds ("Hedge Funds").

During the relevant 27-month period, from mid-August 2009 through November 2011, Eichler executed 4,938 option trades over a total of 600 trading days. The majority of those trades were allocated after a significant amount of time had elapsed since the execution of the trade. Specifically, 3,004 of these option trades – or 60.8% of these option trades – were not allocated until an hour or more had passed following trade execution (hereinafter referred to as the "late-allocated trades"). Only 1,934 option trades (39.2%) were allocated within one hour of execution (hereinafter referred to as the "timely-allocated trades"). For many of the late-allocated trades in question, the position remained open at the time that Eichler allocated the trades (the "open trades"). However, for a significant subset of the late-allocated trades, Eichler did not allocate the trades until he had both bought and sold the position at issue. For these trades, Eichler made allocation decisions with perfect knowledge of a trade's profit or loss (the "perfect information trades"). Of the 3,004 late-allocated trades, 483 were perfect information trades.

When trades were late-allocated, Eichler's favored accounts performed significantly better than the disfavored Hedge Funds. In fact, the 12 option-trading accounts held by Eichler or members of Eichler's family (the "Eichler Accounts") exceeded the average of all late-allocated option trades by 8.4%, whereas the disfavored Hedge Funds performed 4.9% worse than the average. For perfect information trades, the difference was even more significant. Nearly all of the perfect information trades allocated to favored accounts, including the Eichler Accounts, were profitable (98.1%). On the other hand, only 41.4% of the perfect information trades allocated to the disfavored Hedge Funds were profitable. In fact, despite accounting for 77% of the capital invested in perfect information trades, the disfavored Hedge Funds received none of the aggregate profit, and on balance, lost money on the perfect information trades. In contrast, the Eichler Accounts, which accounted for only 9.6% of the total capital invested in perfect information trades, received 49.7% of all trading profits.

In carrying out this "cherry-picking" scheme, Eichler violated the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. § 78j(b)) and Rule 10b-5 thereunder (17 C.F.R. §§ 240.10b-5(a),(c)), and the antifraud provisions of Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act ("Advisers Act") (15 U.S.C. §§ 80b-6(1), (2), (4)), and Rule 206(4)-8(a) thereunder (17 C.F.R. § 275.206(4)-8(a)). On November 4, 2013, Eichler consented to an order requiring him to pay disgorgement, prejudgment interest, and civil penalties in amounts to be determined by this Court [Docket No. 32]. He also consented to an entry of a permanent injunction enjoining him from violating the securities laws. The only remaining issue, which the SEC now moves to resolve, is the disgorgement, penalty, and interest amounts to be entered against Eichler. The SEC seeks a Court order requiring Eichler: (1) to

disgorge \$1,655,923 in ill-gotten profits, along with \$41,749.35 in prejudgment interest; and (2) to pay a one-time civil penalty of \$1,655,923, which represents the amount of Eichler's gross pecuniary gain from his fraudulent scheme.

## II. DISGORGEMENT OF ILL-GOTTEN PROFITS

"[A] district court has broad equity powers to order the disgorgement of ill-gotten gains obtained through the violation of the securities laws. Disgorgement is designed to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable." *SEC v. Platforms Wireless Internat'l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010) (quoting *SEC v. First Pacific Bancorp.*, 142 F.3d 1186, 1191 (9th Cir. 1998)). Although disgorgement may serve as a deterrent, it may not be used punitively. See, e.g., *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989); *SEC v. Sherman*, 491 F.3d 948, 965 n. 19 (9th Cir. 2007).

"[T]he amount of disgorgement should include all gains flowing from the illegal activities." *SEC v. JT Wallenbrock & Assocs.*, 440, F.3d 1109, 1114 (9th Cir. 2006) (quotation marks omitted). Disgorgement need be "only a reasonable approximation of profits causally connected to the violation." *First Pacific Bancorp.*, 142 F.3d at 1192 n. 6. "The SEC bears the ultimate burden of persuasion that its disgorgement figure reasonably approximates the amount of unjust enrichment." *Platforms Wireless Internat'l Corp.*, 617 F.3d at 1096 (quotations and citations omitted). However, "[o]nce the SEC establishes a reasonable approximation of defendants' actual profits, . . . the burden shifts to the defendants to demonstrate that the disgorgement figure was not a reasonable approximation." *Id.* Any doubts regarding the amount to disgorge must be resolved against Eichler because "the risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty." *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1232 (D.C. Cir. 1232).

The Court concludes that the SEC has demonstrated that \$1,655,923 is a reasonable approximation of Eichler's ill-gotten profits. The SEC's expert, David W. Prager, calculated Eichler's incremental profits resulting from the cherry-picking scheme by comparing returns of Eichler's late-allocated trades to Eichler's timely-allocated trades. For option trades that were open at the time of allocation (e.g., the position had not been sold at the time of allocation (the "open trades"), Prager measured investment returns as the gain or loss at the end-of-day on the day that the trade was allocated. This measure represents the built-in mark-to-market profits and losses available to Eichler for evaluation at the time that he allocated the trades. For the remaining trades (the "perfect information trades"), Prager measured investment returns as the known profit or loss arising from Eichler's sale/closing of the option position prior to the allocation of the trade.

During the relevant period, the Eichler Accounts invested \$20,101,504 in late-allocated option trades. As calculated by Prager, the Eichler Accounts received a positive 6.9% investment return on these late-allocated option trades, as measured by end-of-day returns. In contrast, the Eichler Accounts sustained a negative return of 3.2% on timely-allocated option trades. Accordingly, the disparate performance between Eichler's late-allocated trades compared to the timely-allocated trades was 10.1%. Therefore, Eichler's gross profit on late-allocated trades compared to timely-allocated trades was \$2,022,500 (10.1% of the \$20,101,504 invested by the Eichler Accounts in late-allocated options). Prager then adjusted this figure to account for random statistical variance to a 95% confidence level. With that adjustment, Prager determined that



Eichler's incremental profit on late-allocated trades was \$1,655,923.<sup>2</sup>

Eichler primarily argues that, with respect to the open trades, Prager's calculation is not a reasonable approximation of Eichler's ill-gotten gains because it is based on "unrecognized gains" rather than on realized profits. In other words, Eichler criticizes Prager's use of mark-to-market gains or losses, rather than actual profits, for the open trades. However, the Court concludes that the mark-to-market embedded profit or loss at the end of the day of allocation is precisely the gain that Eichler obtained for himself (or family members) as a result of his cherry-picking. Indeed, "[d]isgorgement is an equitable remedy. A manipulator is not relieved of its disgorgement obligation simply because it chooses, for whatever reason, to retain manipulated securities until their subsequent drop in price dissipates some or all of the manipulator's ill-gotten gains." *In re L.C. Wegard & Co.*, SEC Release No. 34-40046, 67 S.E.C. 552, 1998 WL 275929 at \*6 (May 29, 1998), *aff'd*, 189 F.3d 461 (2nd Cir. 1999); *see also SEC v. Shapiro*, 494 F.2d 1301, 1309 (2nd Cir. 1974) ("To require disgorgement only of actual profits in cases where the price of the stock subsequently fell would create a heads-I-win, tails-you-lose opportunity for the violator: he could keep subsequent profits but not suffer subsequent losses."); *SEC v. Mannion*, 28 F. Supp. 3d 1304, 1308-09 (N.D. Ga. 2014) ("[E]very circuit that has addressed the issue has held that disgorgement is properly based on a defendant's unrealized 'paper' profits at the time of the illegal transaction."). Moreover, even if the Court were to rely on Eichler's realized returns on the open trades rather than the mark-to-market embedded profit or loss at the end of the day of allocation, the disgorgement figure would in fact be significantly *higher* than the \$1.656 million requested by the SEC, as established by the Supplemental Declaration of David W. Prager in Support of the SEC's Reply filed on February 18, 2014.

Eichler also argues that he should not be required to disgorge ill-gotten gains from six of the twelve accounts identified by Prager as the "Eichler Accounts" because those accounts were not his personal accounts but accounts held by his wife, his sons, his mother-in-law, and his brother. The Court concludes that the ill-gotten gains from all twelve accounts are subject to disgorgement. *See, e.g., SEC v. Warde*, 151 F.3d 42, 49-50 (2nd Cir. 1998) (affirming district court's order of disgorgement of profits attributable to the defendant's wife and family trust).

For the foregoing reasons, the Court concludes that the SEC has demonstrated a reasonable approximation of Eichler's ill-gotten gains in the amount of \$1,655,923, and that Eichler has failed to demonstrate that the SEC's figure was not a reasonable approximation.

### III. PREJUDGMENT INTEREST

Eichler has consented to an award of prejudgment interest. Accordingly, the Court awards the SEC prejudgment interest in the amount of \$41,749.35, as calculated from the filing of the SEC's complaint to the November 7, 2013 entry of the consent judgment against Eichler and using the IRS rate of interest on tax underpayments and refunds.

### IV. CIVIL PENALTY

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<sup>2</sup>Using this same methodology, Prager determined that the disfavored Hedge Funds suffered incremental losses of at least \$2.3 million.

Finally, the SEC seeks a “third tier” civil penalty against Eichler in the amount of his gross pecuniary gain.

A third tier penalty is available when: (1) the securities law violation “involved fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement;” and (2) “such violation directly or indirectly resulted in substantial losses or created a risk of substantial loss to other persons.” Section 21(d)(3)(B)(iii) of the Exchange Act, 15 U.S.C. § 78u(d)(3)(B)(iii); Section 209(e)(2)(C) of the Advisers Act, 15 U.S.C. § 80b-9(e)(2)(C). The Court concludes that a third tier penalty is appropriate in this case. It is undisputed that Eichler’s securities law violations involved fraud, deceit, manipulation, or a reckless disregard of a regulatory requirement. Complaint at ¶¶ 1-3, 14-30, 33-37, 40-49. In addition, the Court concludes that Eichler’s securities law violations directly or indirectly resulted in substantial losses or created a risk of substantial loss to other persons. Indeed, as calculated by Prager, the disfavored Hedge Funds suffered incremental losses of at least \$2.3 million. The Court concludes, contrary to Eichler’s argument, that this loss is substantial, and thus that third tier penalty is warranted.<sup>3</sup>

The third tier penalty for Eichler’s securities law violations may not exceed the greater of (1) \$150,000 for each violation; or (2) the gross amount of Eichler’s pecuniary gain as a result of the violations. 15 U.S.C. §§ 78u(d)(3)(B)(iii), 80b-9(e)(2)(C); 17 C.F.R. § 201.1004 & Table IV (adjusting statutory amounts for inflation). Civil penalties are “determined by the court in light of the facts and circumstances.” 15 U.S.C. §§ 78u(d)(3)(B), 80b-9(e)(2). “The purpose of imposing monetary penalties in addition to disgorgement of profits is to punish the violator as well as deter future violations of the securities laws.” *SEC v. Indigenous Global Development Corp.*, 2008 WL 8853722, at \*17 (N.D. Cal. June 30, 2008). When deciding on the appropriate penalty for securities law violations, courts frequently consider the factors set forth in *SEC v. Murphy*, 626 F.2d 633, 655 (9th Cir. 1980). Those factors are: (1) the degree of scienter involved; (2) the isolated or recurrent nature of the infraction; (3) the defendant’s recognition of the wrongful nature of his conduct; (4) the likelihood, because of the defendant’s professional occupation, that future violations might occur; and (5) the sincerity of his assurances against future violations. *Id.* Other considerations include (6) whether a defendant’s conduct created substantial losses or the risk of substantial losses to others; (7) a defendant’s lack of cooperation with authorities; and (8) whether the penalty that otherwise would be appropriate should be reduced due to a defendant’s demonstrated current and future financial condition. *SEC v. Apartments America, LLC.*, 2014 WL 842819, at \*6 (C.D. Cal. Mar. 3, 2014) (citing *SEC v. Cavanaugh*, 2004 U.S. Dist. LEXIS 13372, at \* 103-104 (S.D.N.Y. July 16, 2004)).

After carefully weighing all of the relevant factors, the Court concludes that a penalty against Eichler in the amount of his gross pecuniary gain, or \$1,655,923, as requested by the SEC, is appropriate. The Court finds that Eichler acted with a high degree of scienter, that Eichler’s cherry-picking was not an isolated occurrence, that future violations would likely occur if Eichler is not ultimately subjected to an industry bar, and that Eichler’s assurances against future violations are insincere. Indeed, the Court’s finding is heavily influenced by the fact that Eichler was previously

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<sup>3</sup>Even if the \$2.3 million loss to the disfavored Hedge Funds is not considered “substantial,” the Court notes that it still may impose a “second tier” civil penalty against Eichler in an amount equal to the gross amount of pecuniary gain to the defendant.

sanctioned by the SEC in *In re Aletheia Research and Management, Inc., et al.*, SEC Rel. No. 34-64442, 2011 WL 1760239 (May 9, 2011). In that action, Eichler consented, albeit without admitting or denying the SEC's findings, to the entry of an administrative cease-and-desist order in which the SEC found that: (1) Eichler was involved in the failure to conduct an annual surprise examination of Aletheia's hedge funds and to provide the hedge fund investors with quarterly account statements or with timely annual audit reports, thereby willfully aiding and abetting and causing Aletheia's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder; and (2) Eichler was involved in the failure to make and/or keep copies of the employees' acknowledgments indicating receipt of Aletheia's code of ethics thereby willfully aiding and abetting and causing Aletheia's violation of Section 204(a) of the Advisers Act and Rule 204-2(a)(12) thereunder. In that action, the SEC: (1) ordered Eichler to cease and desist from committing or causing any violations and any future violations of the above provisions; (2) censured him; and (3) ordered him to pay a \$100,000 civil penalty. The Court finds it extremely troubling that Eichler's cherry-picking scheme at issue in this action continued throughout the SEC's earlier compliance investigation and his eventual censure in 2011.

The Court has considered Eichler's financial condition, but concludes that the penalty should not be reduced based on this factor. Indeed, the Court affords this factor very little weight given the egregiousness of Eichler's violations. Moreover, the Court is extremely skeptical of Eichler's claimed poor financial condition, given that he paid himself more than \$2.9 million in disclosed compensation in the year leading up to Aletheia's bankruptcy. See *SEC v. Metcalf*, 2012 WL 5519359, at \*8 (S.D.N.Y. Nov. 13, 2012) ("If Metcalf, knowing that he faced the very real possibility of civil financial penalties, chose to spend down his assets, or failed to adjust his lifestyle, that is his problem, not the Commission's or this court's.").

Accordingly, the Court imposes a "third tier" civil penalty in the amount of \$1,655,923, the gross amount of Eichler's pecuniary gain as a result of his securities law violations.

## V. CONCLUSION

For the foregoing reasons, the SEC's Motion for Monetary Remedies Against Defendant Peter J. Eichler is **GRANTED**. The Court signs the proposed Judgment as to Defendant Peter J. Eichler, Jr., lodged with the Court on April 2, 2015 [Docket No. 64-1].

IT IS SO ORDERED.



**EXHIBIT 6**

Release No. 3197 (S.E.C. Release No.), Release No. 64442, Release No.  
34-64442, Release No. IA - 3197, 101 S.E.C. Docket 96, 2011 WL 1760239

S.E.C. Release No.  
Securities Exchange Act of 1934  
Investment Advisers Act of 1940

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF ALETHEIA RESEARCH AND MANAGEMENT,  
INC., PETER J. EICHLER, JR. AND ROGER B. PEIKIN RESPONDENTS.

Administrative Proceeding File No. 3-14374  
May 9, 2011

**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AS TO ALETHEIA RESEARCH AND MANAGEMENT, INC., PETER J. EICHLER, JR. AND ROGER B. PEIKIN**

**I.**

\*1 The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Aletheia Research and Management, Inc. ("Aletheia") and Sections 203(f) and 203(k) of the Advisers Act against Peter J. Eichler, Jr. ("Eichler") and Roger B. Peikin ("Peikin") (Aletheia, Peikin and Eichler referred to as collectively as "Respondents").

**II.**

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and A Cease-and-Desist Order ("Order"), as set forth below.

**III.**

On the basis of this Order and Respondents' Offers, the Commission finds that:

**SUMMARY**

These proceedings concern violations of the Investment Advisers Act by a registered investment adviser, Aletheia, and its two principals, Eichler and Peikin:

- From 2006 to 2008, Aletheia disseminated proposals to client and potential clients that failed to disclose requested information regarding prior Commission examinations, which Peikin reviewed.
  - Aletheia and Peikin failed to implement written procedures reasonably designed to prevent violations of the Advisers Act and rules thereunder regarding responding to requests for proposals from prospective clients.
  - For fiscal years 2003 through 2008, Aletheia, Eichler, and Peikin failed to have an annual surprise examination of Aletheia's hedge funds and to provide the hedge fund investors with quarterly account statements, or provide the hedge fund investors with timely annual audit reports.
- \*2 • From 2005 through 2009, Aletheia, Eichler, and Peikin failed to make and/or keep copies of the employees' acknowledgments indicating the receipt of Aletheia's code of ethics even after receiving 2005 and 2008 deficiency letters notifying Aletheia of that requirement.

### RESPONDENTS

1. Aletheia Research and Management, Inc. ("Aletheia") is a California corporation with its principal place of business in Santa Monica, California. Aletheia (File No. 801-55761) is registered with the Commission as an investment adviser and its wholly-owned subsidiary Aletheia Securities, Inc. ("ASI") is a registered broker-dealer. As of December 31, 2009, it had over \$7.1 billion in assets under management.
2. Peter J. Eichler, Jr. ("Eichler") resides in Pacific Palisades, California. Eichler is Aletheia's co-founder, chairman, CEO, president, Chief Investment Officer ("CIO"), director, and largest shareholder. Eichler is also an officer, director and control person of ASI. He received a B.S. degree from Santa Clara University. Before forming Aletheia, he worked at a number of large brokerage firms. Eichler holds series 7, 24, 63 and 65 securities licenses.
3. Roger B. Peikin ("Peikin") resides in Santa Monica, California. Peikin is Aletheia's co-founder, director, and second largest shareholder. Until February 2010, he was also Aletheia's CCO, and until July 2010, he was its CFO, executive vice president and general counsel. Until July 2010, Peikin was also an officer and control person of ASI. He received his JD from Southwestern University School of Law in 1991 and has been admitted to practice law in California since 1991. Peikin holds a series 27 securities licenses.

### FACTS

#### Background

4. As of December 31, 2009, Aletheia managed over \$7.1 billion in assets for more than 5,400 clients consisting of retail accounts, institutional clients, and two private hedge funds. During the relevant period, Eichler was the CEO and CIO of Aletheia and managed all aspects of Aletheia and was solely responsible for all investment decisions. Peikin was an executive vice president, general counsel, CCO and CFO of Aletheia and was primarily responsible for directing Aletheia's backroom operations. Peikin reported to Eichler.

#### Aletheia's Response To Requests For Proposals

5. As part of their due diligence process for selecting or retaining investment advisers, clients and prospective clients sent Aletheia questionnaires called Request for Proposals ("RFPs") that requested certain information about Aletheia, including information about its background and investment performance. In 10 RFPs between 2005 and 2008, clients and prospective clients asked whether Aletheia had had any "findings," "deficiencies," or "corrective actions required" in connection with the



SEC's prior examination. Some of the RFPs also requested a copy of the SEC's deficiency letter and Aletheia's reply. In response, Aletheia either: (1) stated that "there were no significant findings" in its most recent SEC examination; (2) did not answer the question; (3) referred to its broker-dealer (ASI) when answering the question in the negative and/or (4) provided a copy of the deficiency letter and reply for ASI (rather than for Aletheia).

\*3 6. Aletheia's responses were incorrect. In fact, as part of the 2005 examination, the staff sent Aletheia a seven page letter dated May 13, 2005, reporting six deficiencies found during the exam.

7. Peikin knew or should have known of the 2005 Aletheia exam and deficiencies. He received the deficiency letter and signed Aletheia's reply letter. Peikin participated in the RFP process by reviewing Aletheia's responses to the RFPs. Peikin should have, at a minimum, verified the SEC's deficiency letter in response to the RFPs.

8. As a result of the conduct described above, Aletheia willfully committed violations<sup>1</sup> of, and Peikin willfully aided and abetted and caused violations of, Section 206(2) of the Advisers Act, which makes it unlawful for an adviser to engage in any transaction, practice or course of business that operates as a fraud or deceit upon any client.

#### **Failure to Implement Existing Procedures in Aletheia's Compliance Manual Relating to Responses to the RFPs**

9. Between 2005 and 2008, Aletheia made a concerted effort to attract institutional clients in order to increase the assets that it managed by soliciting prospective clients through its responses to the RFPs. As a direct result, Aletheia's assets under management (and associated management fees) increased from \$225 million in 2005 to over \$9 billion in 2008. Aletheia had a compliance manual that required Peikin, its CCO, to review the response to the RFPs for any misleading statement. However, Peikin failed to adequately review the RFP responses by correcting the misleading statements about the prior SEC examination.

10. As a result of the conduct described above, Aletheia willfully committed violations of, and Peikin willfully aided and abetted and caused violations of, Section 206(4) of the Advisers Act, and Rule 206(4)-7 promulgated thereunder, which requires that an investment adviser registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and rules adopted under the Adviser Act.

#### **Late Hedge Fund Examinations**

11. Aletheia is the general partner and adviser for two private hedge funds, the Aletheia Insider Index, LP ("Index I") and the Aletheia Insider Index II, LP ("Index II"), which had total assets of \$75 million as of December 31, 2009. As a registered investment adviser, Aletheia was required by the Advisers Act and rules thereunder to send quarterly account statements to the limited partners and to ensure that its independent accountant conducted an unannounced (i.e., surprise) annual examination to verify the partnerships' funds and securities. Under an exception and in lieu of these requirements, Aletheia was permitted to complete and distribute to each limited partner an annual audited financial statement within 120 days of the end of the fund's fiscal year, which was December 31.

12. In response to these Advisers Act requirements, Aletheia opted to distribute annual audits to the funds' investors. However, from 2003 through 2008, Aletheia failed to comply with the Advisers Act provisions because it distributed the funds' audited financial statements to the investors from 11/2 to 14 months after they were due.<sup>2</sup>

\*4 13. Aletheia's late distribution of the funds' audited financial statements resulted from many factors, including Aletheia's failure to timely pay the auditors, not having the funds' books and records properly organized for its auditors, problems with its portfolio management software, and Eichler's and Peikin's desire to complete other Aletheia audits or reviews first.



14. Eichler and Peikin were aware of the delays related to each audit. In fact, in some instances they directly caused the delays. For example, Eichler and Peikin jointly were responsible for signing the checks to pay the audit bills that were past due. However, in at least one instance, Eichler and Peikin simply did not jointly sign the check to pay the auditor.

15. As a result of the conduct described above, Aletheia willfully committed violations of, and Eichler and Peikin willfully aided and abetted and caused violations of, Section 206(4) of the Advisers Act, and Rule 206(4)-2(a) promulgated thereunder, which requires that an investment adviser registered with the Commission maintain each client's funds in bank accounts containing only those client funds, notify its clients about the place and manner in which their funds are maintained, reasonable believe that each client has received at least a quarterly account statement and have client funds and securities verified by an independent public accountant at least once a year without prior notice to the investment adviser.

#### **Books and Records - Failure to Make and Keep Acknowledgments**

16. As required by the Advisers Act rules, Aletheia had a code of ethics, which was included in its compliance manual, which required Aletheia to provide the code to all employees and to have each employee sign an acknowledgment that he or she had received the code. The Advisers Act rules also required Aletheia to maintain the signed acknowledgment pages for five years. However, from 2005 through 2007, Aletheia did not make and/or maintain any of the required acknowledgment pages and, for 2008 and 2009, Aletheia only made and/or maintained the required acknowledgment pages for just two employees. Between 2005 and 2009, Aletheia had between 14 and 28 employees.

17. As Aletheia's CCO, Peikin was responsible for receiving and maintaining the acknowledgment pages. Moreover, Aletheia, Peikin and Eichler were advised in the 2005 deficiency letter that not a single Aletheia employee had completed an acknowledgment of receipt. Yet, even though there was sufficient time in 2005 to have the acknowledgment pages signed and retained, they did not. In 2008, Aletheia was once again made aware of the need to make and maintain copies of the acknowledgment pages by the 2008 deficiency letter. Yet, even after receiving a second deficiency letter in four years, Aletheia, Eichler and Peikin failed to make and/or maintain all of the acknowledgment pages for 2008 and 2009.

18. As a result of the conduct described above, Aletheia willfully committed violations of, and Eichler and Peikin willfully aided and abetted and caused violations of, Section 204(a) of the Advisers Act, and Rule 204-2(a)(12) promulgated thereunder, which require that investment advisers registered with the Commission maintain a record of all written acknowledgments as required by Rule 204A-1(a)(5) for each person who is currently, or within the past five years was, a supervised person of the investment adviser.

#### **REMEDIAL EFFORTS**

\*5 19. In determining to accept the Offers, the Commission considered remedial acts undertaken by Respondents and cooperation afforded the Commission staff. Specifically, during the Commission's staff investigation, Aletheia hired an independent consultant (the "Independent Consultant") to evaluate its compliance practices and procedures, and Aletheia is implementing its recommendations.

#### **UNDERTAKINGS**

20. Within thirty (30) days of the issuance of this Order, Respondent Aletheia undertakes to mail a copy of the Form ADV which incorporates the paragraphs contained in Section III of this Order to each of Aletheia's existing clients, and specify that the entire Order will be posted on the homepage of Aletheia's website. Within thirty (30) days of the issuance of this Order, Respondent Aletheia also undertakes to post a copy of this Order on the homepage of Aletheia's website and maintain this copy of the Order on Aletheia's website for a period of six (6) months. Respondent Aletheia shall also provide a copy of the Form ADV to any new client that engages Aletheia or Eichler within one (1) year of the date of this Order.



21. Respondent Aletheia shall comply with the following undertakings:

a. To continue to retain the Independent Consultant, at its expense. Aletheia shall require the Independent Consultant to conduct any additional review of Aletheia's compliance policies and procedures that the Independent Consultant deems appropriate with respect to Sections 204(a), 206(2) and 206(4) of the Advisers Act and Rules 204-2(a)(12), 206(4)-2(a) and 206(4)-(7) thereunder including:

(1) complying with the record retention requirements relating to written acknowledgements;

(2) ensuring that the responses to the RFPs do not contain any material misrepresentations or omissions;

(3) providing quarterly account statements to the limited partners; and hire an independent public accountant to conduct a surprise examination of the adviser's records annually to verify all the clients' funds and securities, or in lieu of these requirements, complying with any statutory exceptions;

(4) adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act, including implementing procedures related to the responses to RFPs; and

(5) complying with such other policies or procedures as are reasonably expected to prevent and detect the types of violations of the federal securities laws involving Aletheia's actions described in Section III;

b. At the end of that review, which in no event shall be more than three (3) months after the date of the issuance of this Order, Aletheia shall require the Independent Consultant to submit to Aletheia and to the Commission's Los Angeles Regional Office an Initial Report. The Initial Report shall describe the review performed, the conclusions reached and shall include any recommendations deemed necessary to make the policies and procedures adequate. Aletheia may suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Independent Consultant. The Independent Consultant shall evaluate Aletheia's proposed alternative procedure. Aletheia, however, shall abide by the Independent Consultant's final recommendation;

\*6 c. Within six (6) months of the date of this Order, Aletheia shall, in writing, advise the Independent Consultant and the Commission's Los Angeles Regional Office of the recommendations it is adopting;

d. Within nine (9) months of the date of this Order, Aletheia shall require the Independent Consultant to complete its review and submit a written final report to Aletheia and the Commission's Los Angeles Regional Office. The Final Report shall describe the review made of Aletheia's compliance policies and procedures relating to Sections 204(a), 206(2) and 206(4) of the Advisers Act and Rules 204-2(a)(12), 206(4)-2(a) and 206(4)-(7) thereunder; set forth conclusions and recommendations and any proposals by Aletheia; and describe how Aletheia is implementing those recommendations and proposals;

e. Aletheia shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Independent Consultant's Final Report;

f. No later than three (3) months after the date of the Independent Consultant's final report, Aletheia shall submit to the Commission's Los Angeles Regional Office an affidavit setting forth the details of its efforts to implement the Independent Consultant's recommendations as set forth in the Final Report and its compliance with them;

g. For good cause shown and upon timely application by the Independent Consultant or Aletheia, the Commission's staff may extend any of the deadlines set forth in these undertakings; and

h. Aletheia shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any



employment, consultant, attorney-client, auditing or other professional relationship with Aletheia, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Los Angeles Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Aletheia, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

22. Aletheia shall certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission's staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to John McCoy, Associate Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Ste. 1100, Los Angeles, CA 90036, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

#### IV.

\*7 In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents Offers.

Accordingly, pursuant to Sections 15(b) of the Exchange Act and Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Aletheia cease and desist from committing or causing any violations and any future violations of Sections 204(a), 206(2), and 206(4) of the Advisers Act and Rules 204-2(a)(12), 206(4)-2(a), and 206(4)-7 promulgated thereunder;

B. Respondent Eichler cease and desist from committing or causing any violations and any future violations of Sections 204(a) and 206(4) of the Advisers Act and Rules 204-2(a)(12) and 206(4)-2(a) promulgated thereunder;

C. Respondent Peikin cease and desist from committing or causing any violations and any future violations of Sections 204(a), 206(2), and 206(4) of the Advisers Act and Rules 204-2(a)(12), 206(4)-2(a), and 206(4)-7 promulgated thereunder;

D. Respondents Aletheia, Eichler and Peikin are censured.

E. Respondent Aletheia shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$200,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Aletheia as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John McCoy, Associate Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Ste. 1100, Los Angeles, CA 90036.

F. Respondent Eichler shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of

Financial Management, Securities and Exchange Commission, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Eichler as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John McCoy, Associate Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Ste. 1100, Los Angeles, CA 90036.

\*8 G. Respondent Peikin shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Peikin as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John McCoy, Associate Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Ste. 1100, Los Angeles, CA 90036.

By the Commission.  
Elizabeth M. Murphy  
Secretary

Footnotes

- 1 A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).
- 2 Index I's first audit was for 2003; Index II first audit was for 2006.

Release No. 3197 (S.E.C. Release No.), Release No. 64442, Release No.  
34-64442, Release No. IA - 3197, 101 S.E.C. Docket 96, 2011 WL 1760239