SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Rel. No. 9088A / December 15, 2009

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61167A / December 15, 2009

Admin. Proc. File No. 3-12559 **CORRECTED**

In the Matter of

GREGORY O. TRAUTMAN

c/o Leon Baer Borstein
Borstein & Sheinbaum
420 Lexington Avenue, Suite 2920
New York, New York 10170

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Antifraud violations

Aiding and abetting antifraud violations

Respondent, who was co-founder, president, and chief executive officer of registered broker-dealer, willfully violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5 by engaging in a scheme to defraud mutual funds and their shareholders through unlawful late trading and deceptive market timing in mutual fund shares on behalf of customers and for broker-dealer's own account. In addition, Respondent willfully aided and abetted, and was a cause of, broker-dealer's violations of Exchange Act Section 15(c) and Exchange Act Rule 10b-3. *Held*, it is in the public interest to bar Respondent from associating with any broker or dealer; to impose a cease-and-desist order; to require disgorgement of $608,886, plus prejudgment interest; and to assess a $120,000 third-tier civil penalty.

APPEARANCES:

Leon Baer Borstein, of Borstein & Sheinbaum, for Gregory O. Trautman.

Alexander M. Vasilescu, *Paul G. Gizzi*, *Robert H. Murphy*, and *Bennett Ellenbogen*, for the Division of Enforcement.

Appeal filed: February 26, 2008
Last brief filed: May 22, 2008
Oral Argument held: July 21, 2009

I.

Gregory O. Trautman ("Trautman"), co-founder, president, and chief executive officer of Trautman Wasserman & Company, Inc. ("TWCO"),[1] a registered broker-dealer, appeals from an administrative law judge's initial decision. The law judge found that, between January 2001 and September 2003, Trautman engaged in a scheme to defraud mutual funds and mutual fund shareholders through late trading and deceptive market timing of mutual fund shares on behalf of TWCO's customers and for TWCO's own account.[2] The law judge concluded that Trautman willfully violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities

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[1] TWCO was named as a respondent in the Order Instituting Proceedings ("OIP") but defaulted by failing to file an answer or otherwise defend the proceeding. *See Trautman Wasserman & Co.*, Initial Decision Rel. No. 340 (Jan. 14, 2008), 92 SEC Docket 1451, 1468. The law judge revoked TWCO's broker-dealer registration, required TWCO to disgorge the amount of its assets not exceeding $9,040,000, plus prejudgment interest, and ordered TWCO to pay a $500,000 civil penalty. We declared that decision final. *Trautman Wasserman & Co.*, Securities Exchange Act Rel. No. 57493 (Mar. 13, 2008), 92 SEC Docket 3317.

[2] In addition to Trautman and TWCO, the OIP named as respondents TWCO's chairman and co-founder Samuel M. Wasserman, TWCO's chief financial officer ("CFO") Mark Barbera, TWCO registered representative James A. Wilson, Jr., TWCO's chief administrative officer Jerome Snyder, and TWCO's chief compliance officer Forde H. Prigot. By the end of the hearing, all of these individual respondents, except for Wasserman, had settled the allegations against them. *See Trautman Wasserman & Co.*, Exchange Act Rel. Nos. 57327, 57328, & 57329 (Feb. 14, 2008), 92 SEC Docket 2241 (Barbera), 2249 (Wilson) & 2422 (Prigot); *Trautman Wasserman & Co.*, Exchange Act Rel. No. 55990 (June 29, 2007), 90 SEC Docket 3109 (Snyder). Following the hearing, the law judge imposed a supervisory bar against Wasserman and ordered him to disgorge $25,000, plus prejudgment interest, for his willful violations of Securities Act Sections 17(a)(2) and 17(a)(3). *See Trautman Wasserman & Co.*, 92 SEC Docket at 1483. We also declared that decision final. *Trautman Wasserman & Co.*, 92 SEC Docket at 3317.

Exchange Act of 1934, and Exchange Act Rule 10b-5.[3] The law judge also concluded that Trautman willfully aided and abetted, and was a cause of, TWCO's violations of Exchange Act Section 15(c) and Exchange Act Rule 10b-3[4] and TWCO's clearing firm's violations of Rule 22c-1 of the Investment Company Act of 1940.[5] The law judge barred Trautman from associating with any broker or dealer; prohibited him from serving or acting in various capacities with respect to a registered investment company; imposed a cease-and-desist order against him; ordered disgorgement of $1,373,799.75, plus prejudgment interest; and assessed a $500,000 third-tier civil penalty. We base our findings on an independent review of the record, except as to those findings not challenged on appeal.

II.

A. Late Trading and Market Timing of Mutual Funds

Mutual fund shares can be bought and sold all day. The price of a mutual fund share is based on its net asset value ("NAV"). NAV is the current market value of a mutual fund's total assets, minus its total liabilities, divided by the total number of shares outstanding. Mutual funds generally calculate NAV once a day,[6] usually when the major United States stock exchanges close at 4:00 p.m. Eastern time.[7] Mutual funds typically disclose in their prospectuses the time

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3 15 U.S.C. §§ 77q(a), 78j(b) & 17 C.F.R. § 240.10b-5 (prohibiting fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities).

4 15 U.S.C. § 78o(c) & 17 C.F.R. § 240.10b-3 (prohibiting fraudulent conduct by brokers or dealers in connection with the purchase or sale of securities).

5 17 C.F.R. § 270.22c-1(a) (prohibiting dealers in a mutual fund's shares, among others, from effecting a trade at a day's price if the trade was received after the time when the mutual fund had calculated that day's price). Trautman was not charged with directly violating Rule 22c-1 because he is not within the class of persons or entities subject to its provisions. *See id.* We have determined not to address Trautman's secondary liability for TWCO's clearing firm's violations of Rule 22c-1. *See infra* n. 75.

6 *See* 17 C.F.R. § 270.22c-1(b)(1) (generally requiring mutual funds to calculate their NAVs at least once daily, Monday through Friday, but providing for certain exceptions).

7 *See, e.g., DH2, Inc. v. SEC*, 422 F.3d 591, 592 (7th Cir. 2005) (stating that a mutual fund's NAV is "generally fixed by a fund when the major U.S. stock markets close at 4:00 p.m. [E]astern time"); *SEC v. Simpson Capital Mgmt., Inc.*, 586 F. Supp. 2d 196, 199 (S.D.N.Y. 2008) (stating that "[t]he prices of mutual fund shares are not continually reset over the course of the day, but are typically fixed for an entire day at a single price. Mutual funds . . . generally

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when NAV is computed. The prospectuses of mutual funds traded by TWCO and its customers disclosed that the funds calculated NAV "at" the close of regular trading on the New York Stock Exchange ("NYSE"), normally 4:00 p.m. Many of the prospectuses stated that the funds had to receive orders by 4:00 p.m. in order to be executed at that day's NAV. Some of the prospectuses further stated that the time of receipt of an order by a mutual fund intermediary, rather than by the mutual fund itself, was the time for determining the price that the order would receive.[8] It therefore follows that an investor who places a mutual fund order before 4:00 p.m. will receive that day's NAV, while an investor who places an order after 4:00 p.m. will receive the next day's NAV.

"Late trading" refers to the unlawful practice of permitting mutual fund orders received after the 4:00 p.m. pricing time to receive the NAV calculated as of 4:00 p.m. the same day, instead of 4:00 p.m. the following day.[9] Late trading enables the trader to profit from market

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[7] (...continued)
determine the NAV of mutual fund shares at the close of the major United States securities exchanges and markets – 4:00 p.m. ET [Eastern Time]."); *Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings*, Investment Company Act Rel. No. 26287 (Dec. 11, 2003), 81 SEC Docket 2971, 2976 (proposed rule) (stating that, "[t]ypically, mutual funds calculate their NAVs once each day at or near the close of the major U.S. securities exchanges and markets (usually 4:00 p.m., Eastern time)"). All times referenced in this opinion are Eastern time.

[8] *See Amendments to Rules Governing Pricing of Mutual Fund Shares*, Investment Co. Act Rel. No. 26288 (Dec. 11, 2003), 81 SEC Docket 3177, 3179 (stating that under Investment Company Act Rule 22c-1 mutual fund orders must be submitted to dealers and other intermediaries by 4:00 p.m. in order to receive the current day's share price); *Staff Interpretive Positions Relating to Rule 22c-1*, Investment Co. Act Rel. No. 5569 (Jan. 9, 1969), 1969 WL 96373 (stating that Investment Company Act Rule 22c-1 "contemplates that the time of receipt of the order by the retail dealer is controlling" for determining the price that the order receives).

[9] *See, e.g., SEC v. Pentagon Capital Mgmt. PLC*, 612 F. Supp. 2d 241, 248 (S.D.N.Y. 2009) (stating that late trading "refers to the practice of placing orders to buy, redeem or exchange U.S. mutual fund shares after the time as of which the funds calculate their NAV, but receiving the price based on the prior day's NAV"); *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d 845, 852 n.1 (D. Md. 2005) (stating that late trading is "the practice of placing orders to buy or sell mutual fund shares after 4:00 p.m. ET [Eastern Time], but receiving the price based on the prior NAV already determined as of 4:00 p.m. that same day") & *id.* at 856 (holding that "[l]ate trading is itself illegal, and therefore, as alleged by plaintiffs, a scheme, practice, or course of business effectuating late trading is inherently fraudulent"); *Scott G. Monson*, Investment Co. Act Rel. No. 28323 (June 30, 2008), 93 SEC Docket 7517, 7518 n.2 (stating that "[t]he illegal practice of permitting a purchase or redemption order received after the fund calculates its NAV
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events, such as earnings announcements and futures trading, that occur after 4:00 p.m. but are not reflected in the current day's NAV. The late trader obtains an advantage, at the expense of other shareholders of the mutual fund, when he learns of market moving information and is able to buy or sell mutual fund shares at NAVs set before the market moving information is released. Late trading violates the "forward pricing rule" set forth in Investment Company Act Rule 22c-1,[10] which requires the price of mutual fund shares to be set at the NAV "next computed" by the fund

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[9] (...continued)
(typically 4:00 p.m. Eastern Time) to receive the same day's NAV is referred to as 'late trading'"); *Charles C. Fawcett*, Exchange Act Rel. No. 56770 (Nov. 8, 2007), 91 SEC Docket 3147, 3148 n.4 (stating that "[l]ate trading is the illegal practice of permitting a purchase or redemption order received after the 4:00 p.m. pricing time to receive the share price calculated as of 4:00 p.m. that day") (internal quotations and citation omitted).

[10] Decisions interpreting Rule 22c-1 have read it to prohibit mutual fund investors from trading a fund's shares after the 4:00 p.m. pricing time while still receiving that day's NAV. *See Simpson Capital Mgmt.*, 586 F. Supp. 2d at 202 (holding that Rule 22c-1's requirement that the price of mutual fund shares be set at the NAV "next computed" by a mutual fund after the receipt of an order to buy or sell shares established that the time for setting NAV is the time "as of" which the NAV is calculated, generally 4:00 p.m., and not, as defendants argued, the time when the calculation is actually made) & *id.* at 203 (stating that defendants' interpretation of the Rule "would allow dealers to provide their customers with the same day's NAV on mutual fund trades submitted until the actual point of NAV calculation and would allow an end run around Congress's and the Commission's intent to prevent dilution of share value, speculative trading, and unfair treatment of investors"); *SEC v. JB Oxford Holdings, Inc.*, No. CV-04-7084 PA (C.D. Cal. Aug. 24, 2005) (unpublished minute order) (giving deference to Commission's interpretation of Rule 22c-1 setting the relevant "as of" time as the time that a mutual fund values its holdings for purposes of pricing mutual fund trades, rather than the time a fund actually performs its NAV calculation); *Paul A. Flynn*, Initial Decision No. 316 (Aug. 2, 2006), 88 SEC Docket 2146, 2173-74 (ALJ decision) (holding that the phrase "NAV that is next computed" means the NAV as of the time the mutual fund sets for its calculation, which is typically 4:00 p.m.), *declared final*, Exchange Act Rel. No. 54390 (Aug. 31, 2006), 88 SEC Docket 2649; *see also, e.g., Prusky v. Reliastar Life Ins. Co.*, 445 F.3d 695, 698 n.5 (3d Cir. 2006) (stating that "[t]he term 'late trading' is somewhat misleading because trading after the close of the market is entirely permissible so long as the trades are priced using the NAV set the next day. The Rule [Rule 22c-1]'s requirement that prices be based on the next computed NAV is referred to as 'forward pricing.' Thus, late trading may be more aptly described as violating the forward pricing rule.") (citations omitted); *Amendments to Rules Governing Pricing of Mutual Fund Shares*, 81 SEC Docket at 3178 (stating that "[l]ate trading not only violates [R]ule 22c-1, but managers who permit late trading also breach their fiduciary duties to the funds and fund shareholders").

after the receipt of an order to buy or sell shares.[11] Late trading harms innocent mutual fund shareholders by diluting the value of their investment.[12]

"Market timing" includes the frequent buying and selling of shares of the same mutual fund in order to exploit inefficiencies in mutual fund pricing.[13] Market timing, while not itself illegal, can harm mutual fund shareholders by, among other things, diluting the value of their shares (if the market timer is exploiting pricing inefficiencies), disrupting the management of the mutual fund's investment portfolio, and causing the targeted mutual fund to incur costs borne by

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[11] Investment Company Act Rule 22c-1's primary purpose is to prevent dilution-based abuses related to "backward pricing," the practice of basing the price of a mutual fund share on the NAV determined as of the close of the markets on the previous day. *See, e.g., Adoption of Rule 22c-1 under the Investment Company Act of 1940 Prescribing the Time of Pricing Redeemable Securities for Distribution, Redemption, and Repurchase and Amendment of Rule 17a-3(a)(7) under the Securities Exchange Act of 1934 Requiring Dealers to Time-Stamp Orders*, Investment Co. Act Rel. No. 5519 (Oct. 16, 1968), 1968 WL 87057; *see also, e.g., United States v. NASD*, 422 U.S. 694, 707 (1975) (explaining that the "interim period" between the calculation of a mutual fund's closing price on the previous day and the next-day opening price based on the NAV at the current day's closing provides opportunities to engage in "riskless trading" by exploiting the price difference).

[12] *Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 248; *see In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 852 n.1 (discussing plaintiff's allegations of adverse affects of late trading and market timing).

[13] *Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 253; *see, e.g., SEC v. Ficken*, 546 F.3d 45, 48 (1st Cir. 2008) (stating that "[m]arket timing is a mutual fund share trading strategy that exploits brief discrepancies between the stock prices used to calculate the shares' value once a day, and the prices at which those stocks are actually trading") (internal quotations and citation omitted); *In re Mut. Funds Inv. Litig.*, 529 F.3d 207, 210-11 (4th Cir. 2008) (describing market timing as a form of arbitrage in which "investors move in and out of the funds to take advantage of the temporary differentials between the mutual funds' daily calculated 'net asset value' ('NAV') and the market price of the component stocks during the course of a day"); *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 852 n.1 (observing that "[m]arket timing is the frequent buying and selling of mutual fund shares to exploit any lag between changes in the value of the fund's portfolio of securities and the reflection of that change in a mutual fund's share price"); *SEC v. Pimco Advisors Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 458 (S.D.N.Y. 2004) (stating that "[m]utual fund market timing is a form of arbitrage activity that takes advantage of small short-term fluctuations in mutual fund prices"), *reconsideration denied sub nom. SEC v. Treadway*, 354 F. Supp. 2d 311 (S.D.N.Y. 2005).

other fund shareholders to accommodate the market timer's frequent buying and selling of shares.[14]

During the relevant period, mutual funds sought to detect and prevent harmful market timing activity. Representatives from several mutual funds testified at the hearing about their respective funds' anti-market timing policies, which generally were disclosed in the funds' prospectuses. Those policies included restrictions on frequent trading in the funds. Traders identified by the mutual funds as market timers typically received letters warning them that they could not use the funds to engage in market timing, had their accounts blocked or frozen, and in some cases were banned from subsequent trading in the funds.

B. Trautman and TWCO

Trautman began his career in the securities industry in 1988. Over the ensuing years, he obtained several securities licenses, including supervisory licenses.[15] Trautman was associated with five other broker-dealers before co-founding TWCO, a small registered broker-dealer headquartered in New York, New York, in 1993. Trautman was TWCO's president and chief executive officer and owned approximately thirty-eight percent of the firm. Before 2001, TWCO's primary business was raising venture capital from accredited investors for investment in private equity companies. The firm also had a retail brokerage business.

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[14] *See, e.g., Ficken*, 546 F.3d at 48 (stating that, "[a]lthough market timing is not illegal, mutual fund companies often prohibit market timing in order to protect long-term shareholders from dilution or other adverse effects caused by rapid and repeated short-term mutual fund transactions"); *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 856 (stating that "[m]arket timing . . . is not illegal per se," but that "it nevertheless is prohibited by [Exchange Act] Rule 10b-5 if it is engaged in by favored market insiders at the expense of long-term mutual fund investors from whom it is concealed and who have a right to rely upon its prevention by fund advisers' and managers' good faith performance of their fiduciary obligations"); *Pimco Advisors Fund Mgmt.*, 341 F. Supp. 2d at 458 (stating that, "[w]hile market timing can be a successful strategy for individual investors and is not itself illegal, it can also harm investors in a mutual fund that permits market timing by increasing trading and brokerage costs, as well as tax liabilities incurred by a fund and spread across all investors. The quick pace of investments and redemptions associated with market timing may also hinder the ability of mutual fund managers to act in the best interests of fund investors who seek to maximize their long-term investment gains."). For a fuller discussion of mutual fund market timing and the problems it can cause, *see generally Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings*, Securities Act Rel. No. 8343 (Dec. 11, 2003), 81 SEC Docket 2971.

[15] NASD (now FINRA) revoked Trautman's NASD registration in June 2007 for failure to pay fines and/or costs in a case. Trautman testified that he "would very much like to have a license at some point in the future."

Trautman was actively involved in the firm's daily business. James Wilson, a TWCO registered representative,[16] testified that Trautman, as a name partner, was highly visible within the firm and had hands-on involvement in all aspects of the firm's operations. According to Wilson, Trautman "walked around and spoke to everybody. [He] [w]as involved in personal matters with people [and] professional matters with people. He was involved in the hiring process. He had his fingerprints definitely on [the] firm." TWCO's co-founder and chairman, Samuel Wasserman, echoed this view, stating that "everybody reported" to Trautman.

C. TWCO Establishes New Mutual Fund Market Timing Department

In 2000, in an attempt to increase the firm's business, Wasserman recruited Wilson and Wilson's junior colleague, Scott Christian,[17] to establish a mutual fund market timing department

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[16] In settlement of the OIP's allegations against him, Wilson consented to the entry of a judgment ordering him to cease and desist from committing or causing any violations or future violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5, from causing any violations or future violations of Exchange Act Sections 15(c) and 17(a) and Exchange Act Rules 10b-3 and 17a-3, and from committing or causing any violations or future violations of Investment Company Act Rule 22c-1; barring him from association with any broker or dealer; prohibiting him from serving or acting in various capacities with respect to a registered investment company; imposing disgorgement of $534,160, plus $145,840 in prejudgment interest; and assessing a $120,000 civil penalty. *Trautman Wasserman & Co.*, 92 SEC Docket at 2258.

[17] In July 2005, Christian pleaded guilty in New York state court to a Class E felony for securities fraud. The guilty plea arose out of the same misconduct underlying this proceeding. As part of his plea agreement, Christian agreed to testify and cooperate with the New York Attorney General's ("NYAG") Office and the Commission. Christian also agreed to be barred from association with any broker or dealer pursuant to a follow-on administrative proceeding. *Scott A. Christian*, Exchange Act Rel. No. 52163 (July 29, 2005), 85 SEC Docket 4345.

In April 2007, Wilson pleaded guilty in New York state court to a Class E felony for securities fraud and received a three-year conditional discharge. *People v. Wilson*, No. 04188-2006 (N.Y. Sup. Ct. Apr. 4, 2007). In light of Wilson's plea, in June 2007, Christian was allowed to re-plead to a misdemeanor charge and received an unconditional discharge. *People v. Christian*, No. 03409-2005 (N.Y. Sup. Ct. June 21, 2007). Around this same time, Christian also settled a civil injunctive action brought by the Commission in the United States District Court for the Southern District of New York. *SEC v. Christian*, Civ. No. 05-CV-06239 (LTS) (S.D.N.Y. June 19, 2007). Christian, without admitting or denying the Commission's allegations, consented to the entry of a judgment enjoining him from violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5, and from aiding and abetting

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at TWCO. TWCO had not been engaged in the mutual fund market timing business before Wilson and Christian joined the firm. Wilson and Christian operated as a team, with Wilson acting as the superior and Christian handling day-to-day operations.

In a pre-employment interview, Wilson described to Wasserman his mutual fund market timing business. Wilson stated that, as part of the business, he wanted mutual fund managers to give him market timing "capacity," meaning the ability to gain access to mutual funds and be allowed to freely market time them even if the funds' prospectuses stated that the funds did not allow market timing. Wilson told Wasserman that he could raise a billion dollars in assets through customers with whom he had relationships.

Wilson further told Wasserman that it was important that TWCO's clearing firm be able to support the type of business that he conducted. TWCO cleared its transactions through Bank of America Corporation ("BOA").[18] BOA gave TWCO an instruction manual for processing mutual fund trades. BOA's manual specified that "[a]ll orders should be received and time-stamped [by TWCO] by the close of the NYSE [New York Stock Exchange], 4 p.m. EST [Eastern Standard Time]. With MFRS [Mutual Fund Order Entry System] you will have until 5:15 EST to enter and review those orders time stamped by 4 pm EST." The purpose of the review period was to allow brokers to correct any errors in the orders received by 4:00 p.m. The review period did not provide additional time for brokers to submit new orders, or to confirm, modify, or cancel orders already submitted, after the NYSE's regular trading session closed at 4:00 p.m.

Wilson and Christian met twice with BOA before they joined TWCO in December 2000. Following the second meeting, BOA representative Matthew Augugliaro informed Wilson and Christian privately that BOA's platform would allow TWCO to enter its mutual fund orders directly into BOA's system until 6:30 p.m., but still obtain that day's NAV, and that a hedge fund customer in San Francisco was already using the system to submit trades at 6:30 p.m.[19]

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[17] (...continued)
violations of Exchange Act Sections 15(c) and 17(a) and Exchange Act Rules 10b-3 and 17a-3. The final judgment further directed him to pay $250,000 in disgorgement.

[18] In February 2005, BOA entered into a settlement with the Commission regarding its facilitation of market timing and late trading by certain introducing broker-dealers. *See Banc of Am. Capital Mgmt.*, Exchange Act Rel. No. 51167 (Feb. 9, 2005), 84 SEC Docket 3046.

[19] In a February 2004 report following a cause examination of TWCO, Commission staff found that the MFRS system required mutual fund transactions to be entered individually, but applied no constraints as to the time of entry. According to the staff report, a mutual fund transaction entered into the MFRS system before the final 8:30 p.m. batching time would be transmitted to the National Securities Clearing Corporation's ("NSCC") Fund/SERV (a national
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Trautman testified that BOA representatives Augugliaro and Stuart Heller told him that TWCO's customers would be able to enter orders directly into BOA's system after 4:00 p.m. Trautman stated that he understood that BOA's system "would allow us [TWCO] to bypass faxing tickets to Bank of America for entry[,] [a]nd that we would have the ability . . . to confirm or cancel orders up until cut-off times" of 5:30 p.m. or 6:30 p.m. Trautman claimed that he was unaware that BOA had a policy requiring mutual fund orders to be received and time-stamped by the introducing broker by 4:00 p.m.

D. TWCO's Late Trading and Deceptive Market Timing Scheme

TWCO's market timing customers consisted of eight institutions, Alastor Capital Management ("Alastor"), Beacon Rock Capital ("Beacon Rock"), Canadian Imperial Banking Corporation or Canadian Imperial Holdings Inc. ("CIBC"), DLR Advisors ("DLR"), Folkes Asset Management ("Folkes") (now Headstart Advisers Limited), Johnson Capital Management ("Johnson"), Pentagon Capital Management ("Pentagon Capital"), and Ritchie Capital Management ("Ritchie Capital");[20] two individuals, Jeffrey Augen[21] and Daniel Rosenthal; and a Wilson Trautman Christian ("WTC") proprietary account. TWCO acted as introducing broker in processing customers' mutual fund trades through BOA.

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[19] (...continued)
clearing system) with instructions to purchase or sell the funds at the NAV calculated as of 4:00 p.m. that day. Thus, anyone with direct access to the MFRS system had the ability to enter mutual fund orders after 4:00 p.m. but still receive the same day's NAV. Selected BOA customers and correspondent firms, including TWCO, were given direct access to the MFRS system. Direct access also allowed TWCO to enter orders to be batched and transmitted to NSCC without having to submit to the supervisory review provided by BOA's Mutual Fund Operations Department. The February 2004 report was forwarded to the Division of Enforcement.

[20] Federal criminal, civil, or administrative actions have been brought against most of TWCO's institutional customers for late trading and/or deceptive market timing activities between 1999 and 2003. *See United States v. Beacon Rock Capital, LLC*, Litig. Rel. No. 20567 (May 12, 2008), 2008 WL 2018278; *SEC v. Headstart Advisers Ltd.*, Litig. Rel. No. 20524 (Apr. 10, 2008), 2008 WL 1004151; *SEC v. Pentagon Capital Mgmt. PLC*, Litig. Rel. No. 20516 (Apr. 3, 2008), 2008 WL 899195; *Ritchie Capital Mgmt. LLC*, Securities Act Rel. No. 8890 (Feb. 5, 2008), 92 SEC Docket 1492; *Canadian Imperial Holdings, Inc.*, Securities Act Rel. No. 8592 (July 20, 2005), 85 SEC Docket 3848.

[21] Among other duties, Trautman advised a private equity company named TurboWorx Inc. During the relevant period, Trautman was chairman, and Jeffrey Augen was president and chief executive officer, of TurboWorx.

TWCO's market timing business included late trading, using BOA's processing system. Wilson and Christian admitted that they engaged in late trading and market timing on behalf of TWCO's customers and for the firm's WTC account.[22] TWCO's customers used trading models that gave signals of when they should move their money into or out of the markets. Those signals included changes in the futures markets of more than one and one-half percent and corporate earnings announcements after the NYSE closed at 4:00 p.m. but before 6:30 p.m.

Christian described the typical daily routine for handling mutual fund orders. Between noon and 2:00 p.m., TWCO received proposed orders from Alastor, DLR, Folkes, and Johnson. TWCO did not receive proposed orders from Beacon Rock, Pentagon Capital, Ritchie Capital, and the CIBC, WTC, Augen, and Rosenthal accounts. Rather, TWCO employees generated those orders.

Christian and other TWCO personnel did not time-stamp orders when they were received from the customer or generated by the firm, but waited instead until between 3:45 p.m. and 4:00 p.m. to start time-stamping orders. Christian sometimes forgot to time-stamp orders before 4:00 p.m., resulting in some order tickets time-stamped after 4:00 p.m., so he began to use an alarm clock to remind himself to time-stamp all proposed orders before 4:00 p.m. Christian testified that he time-stamped proposed orders before 4:00 p.m. because he wanted to make it appear as though they were received by the 4:00 p.m. close of the markets, and because his understanding was that all orders had to be time-stamped before 4:00 p.m.

The time-stamped orders were mere place holders for the actual trades made after the markets' close. Christian and other TWCO personnel did not re-stamp order tickets when the actual trading decisions were made after 4:00 p.m. Nor did they create cancelled order tickets for post-4:00 p.m. cancelled trades. In fact, when customers cancelled trades, TWCO personnel threw the original order tickets away. When customers confirmed trades, TWCO personnel entered the orders into BOA's system for processing. All of the confirmed orders received the current day's NAV.

Beacon Rock, Pentagon Capital, Ritchie Capital, and the CIBC, WTC, Augen, and Rosenthal accounts typically confirmed, modified, and/or cancelled orders after 4:00 p.m., up until 5:30 p.m. or 6:30 p.m., at which point Wilson and/or Christian executed the orders and the customers received that day's NAV. From February 2001 to September 2003, TWCO placed a total of approximately 9,500 trades for at least four of these customers -- Beacon Rock, Pentagon Capital, Ritchie Capital, and the WTC account -- in a minimum of eight mutual funds or fund families whose prospectuses stated that NAV was determined at 4:00 p.m. when regular trading on the NYSE closed, and that a trade had to be received by the 4:00 p.m. close in order to obtain

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[22] At the hearing, the law judge asked the parties if there was "any doubt" from Wilson's and Christian's testimony that they admitted "to what we now consider late trading and market timing." Trautman's counsel affirmed that Wilson and Christian admitted to having engaged in late trading and market timing, and stated, "[S]o do we."

that day's NAV.[23] Christian testified that neither he nor anyone else that he knew at TWCO reviewed any of the prospectuses of the mutual funds that TWCO late traded.

By Christian's estimates, seventy-five percent of Pentagon Capital's mutual fund orders, ninety to ninety-five percent of Ritchie Capital's orders, one hundred percent of Beacon Rock's orders, one hundred percent of CIBC's orders, and sixty percent of the WTC account's orders were placed after 4:00 p.m., with each customer receiving the same day's NAV for each order placed after 4:00 p.m. Wilson testified that a "majority" of TWCO's mutual fund trades during the relevant period consisted of late trades, always for the same day's NAV.[24] Wasserman testified that Christian told him that "virtually all" of TWCO's mutual fund trades were late trades.[25]

Wilson and Christian both testified that Trautman knew about the late trading at TWCO. Wilson stated that Trautman was present in his and Christian's office, often sitting in Wilson's chair, when mutual fund orders came in and customers submitted their trading orders, "generally all after 4 o'clock." Christian stated that he and Trautman had extensive, daily discussions about TWCO's late trading. On several occasions, the subject of the legality of the late trading came up in discussions among Wilson, Christian, and Trautman. According to Christian, the three of them referred to TWCO's ability to late trade as taking "advantage" of an "operational loophole" in BOA's processing system, in order to "justify" the trading to themselves.[26]

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[23] The eight mutual funds or fund families were: Janus Mercury Fund; Invesco Technology Funds; Alliance Premier Growth; SEI Institutional International Trust; Nations International Equity Fund; Credit Suisse International Focus Fund; Franklin Funds; and Hartford-Fortis Series Fund.

[24] Between January 2001 and September 2003, TWCO's mutual fund department executed a total of approximately 81,650 mutual fund trades.

[25] The law judge found that Wasserman gave credible testimony. A law judge's credibility findings are entitled to considerable weight and deference. *See, e.g.*, *Warwick Capital Mgmt., Inc.*, Investment Advisers Act Rel. No. 2694 (Jan. 16, 2008), 92 SEC Docket 1410, 1413 n.9.

[26] Christian testified: "There were a couple of other times . . . where legal/illegal came up and Jim [Wilson] and I would sit there and we would talk about how we felt about what we were doing every day. And we would justify it [the ability to late trade] to ourselves, call it an operational loophole, make ourselves feel better about what we had just heard or what somebody had said about the business. And I recall Greg Trautman having those conversations with us."

E. TWCO's Practices to Circumvent Mutual Funds' Anti-Market Timing Policies

Christian estimated that he and Wilson conducted between two and three hundred trades per day in a total of over one hundred different mutual fund families. When their mutual fund trading was identified by mutual funds as violating the funds' anti-market timing policies, the funds would send TWCO (or BOA, as TWCO's intermediary) "kick-out" letters freezing accounts and restricting subsequent trading. Between 2001 and 2003, TWCO's mutual fund trading resulted in over three hundred "kick-out" letters from approximately forty mutual fund families. The volume of kick-out letters decreased beginning in mid-2002 when Wilson and Christian started focusing most of their trading in funds that allowed market timing, usually because TWCO had market timing arrangements whereby the funds provided capacity to TWCO in exchange for TWCO customers' maintaining "sticky assets," *i.e.*, long-term investments of capital, in the funds.

To circumvent mutual funds' anti-market timing policies, Christian testified that he and Wilson engaged in a variety of practices to stay "under the radar" of the "mutual fund police," meaning mutual fund internal compliance monitors who sought to identify and prevent market timing trades.[27] Christian's and Wilson's practices included opening multiple accounts for the same customer and creating new registered representative identification numbers to hide their identity from the funds.[28] Christian affirmed that by opening multiple accounts and

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[27] Wilson testified that he did not think that TWCO's mutual fund department engaged "specifically" in "under the radar" practices, but acknowledged that its activities "could be viewed" as such.

[28] Courts, as well as the Commission, have found such practices to be deceptive. *See, e.g., Ficken*, 546 F.3d at 51-52 (finding that the defendant's use of duplicative financial advisor and customer account numbers to deceive mutual funds met the scienter requirement of the federal securities laws' antifraud provisions); *Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 262 (stating that "[t]he systematic use of multiple accounts and broker-dealers to conceal market timing trades from mutual funds may be better described as the use of a fraudulent device"); *SEC v. Gann*, No. Civ. A. 305CV0063L, 2006 WL 616005 (N.D. Tex. Mar. 13, 2006) (denying motion to dismiss complaint for securities fraud where defendants engaged in mutual fund market timing scheme using deceptive practices to avoid detection by mutual funds; deceptive practices included using multiple accounts, multiple registered representative numbers and multiple branch office codes, and dividing trades into smaller dollar amounts); *Michael Sassano*, Securities Act Rel. No. 8945 (July 18, 2008), 93 SEC Docket 7942 (settled proceeding) (finding that respondent engaged in deceptive practices in connection with fraudulent late trading and market timing scheme, including: using multiple accounts, including cloning of new accounts; creating new registered representative numbers to disguise himself and customers from the mutual funds; sending trades from a different branch to deceive mutual funds about the origins of

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continuing to trade, despite mutual funds' efforts to halt the trading, he was deceiving the mutual funds.

F. Trautman's Role in TWCO's Scheme

Trautman claimed that he had "no understanding" of Wilson's and Christian's mutual fund market timing business when TWCO hired them. However, Wilson testified that, during his interviews, he "absolutely" discussed his mutual fund market timing business with both Trautman and Wasserman. Wasserman testified that he was "sure" all of his partners, including Trautman, understood the nature of Wilson's business from its inception at the firm because he would not have started a new business without their "assent or consent," and because either he or Wilson would have explained the business to them.

Trautman testified that he understood that market timing activities could harm mutual funds. As an example, Trautman stated that the "undisclosed and unanticipated rapid buying and selling of securities in a small fund or an illiquid fund could be harmful to the fund manager's ability to manage his portfolio positions." Trautman testified that he knew that there were "bad" market timers or "cowboys" who "would trade hundreds of times a year or trade in and out [of funds] without the fund managers knowing." Trautman also knew that mutual funds sought to monitor or restrict market timing and issued "kick-out" letters to freeze known market timers' accounts and prevent them from trading. In fact, Trautman specifically recalled "one instance" when he was in Wilson's and Christian's office and a "kick-out" letter received by TWCO was discussed.

Trautman admitted that he regularly visited Wilson's and Christian's office "two, three, [or] four times a week" to "educate" himself about their mutual fund market timing business. Trautman testified that he understood that TWCO's customers submitted mutual fund orders before 4:00 p.m. and confirmed or cancelled those orders between 5:30 p.m. and 6:30 p.m.[29]

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[28] (...continued)
the trade; trading in smaller amounts to avoid detection by the funds, including using an in-house electronic trading platform to break up trades into small dollar volumes; and using annuities to avoid restrictions on market timing; and using trading platforms of other broker-dealers to continue market timing mutual funds that blocked their customers' trading).

[29] Counsel for Trautman conceded at the hearing that Trautman "knew at all times that orders were being written up before 4 o'clock and time-stamped, and that after 4 o'clock the hedge fund managers [were] amending -- canceling the order[s] until 5:30 [p.m.]."

However, Trautman denied knowing that mutual fund orders had to be placed by 4:00 p.m. or that regular trading on the NYSE closed at 4:00 p.m.[30]

In his testimony, Trautman characterized the ability of TWCO's customers to confirm or cancel mutual fund orders after 4:00 p.m. as "time arbitrage." Trautman affirmed that TWCO's customers who submitted trading instructions after 4:00 p.m. would receive the same day's NAV, which was determined as of 4:00 p.m., before market news came out. Trautman understood that customers who placed post-4:00 p.m. orders had the "ability to respond to anything that takes place [in the market] up until the point that they had to make their [trading] decision[,] and the longer they had to make the decision[,] the better it was for them." Trautman acknowledged that he understood that TWCO's ability to place post-4:00 p.m. trades was a "selling point" for the firm. However, Trautman denied knowing that TWCO customers' post-4:00 p.m. confirmation or cancellation orders constituted changes to the orders submitted before 4:00 p.m.

Trautman testified that "time arbitrage" trading had been going on for "several years" at TWCO. He thought that TWCO's trading after 4:00 p.m. took advantage of "stale pricing." Trautman did not think that there was anything wrong with "time arbitrage" trading because he knew that "there were serial arbitrage or client strategies . . . relat[ing] to stale pricing that were legal." However, Trautman admitted that he never consulted counsel regarding the legality of TWCO's late trading.

Trautman testified that he heard from Wilson, Christian, and another individual about supposed legal opinions or Commission no-action letters that ostensibly supported the legality of late trading in mutual fund shares.[31] However, as he acknowledged in testimony, Trautman never

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[30] The law judge did not believe Trautman when he professed a lack of knowledge of these matters. She found his testimony generally to be not credible because, in her words, it was often "inconsistent and/or false." Trautman has not shown, nor do we find, any substantial evidence contradicting the law judge's credibility findings. *See, e.g., Warwick Capital Mgmt.*, 92 SEC Docket at 1413 n.9.

[31] Christian testified that he obtained a copy of a Commission no-action letter from a friend in February 2003 and brought the no-action letter to the office to share with Wilson. Wilson had additional copies of the no-action letter made and left one for Trautman on his desk. Christian "skimmed" the no-action letter, but did not see how it applied to TWCO's mutual fund trading. The no-action letter, which is in the record, discussed the purposes underlying Investment Company Act Rule 22c-1, including the elimination of share dilution resulting from "backward pricing." *See Charles Schwab & Co.*, SEC No-Action Letter, 1997 WL 447915 (July 7, 1997). The no-action letter concluded that a customer order placed with the broker-dealer before a mutual fund's pricing time, typically 4:00 p.m., could receive the price calculated as of the pricing time even if the order was transmitted to the fund after the pricing time. Here,

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asked for or looked at any legal opinions or Commission no-action letters during the relevant period. Trautman claimed that it was only after TWCO's receipt of a subpoena in August 2003 in connection with an investigation of mutual fund trading by the NYAG that the trading that he called "time arbitrage" was considered to be late trading. Trautman stated that, before the firm's receipt of a subpoena from the NYAG, he "never reviewed [order] tickets [and] never looked at their [Wilson and Christian's] business" in "detail."

1. Trautman Made Late Trading Decisions

WTC Account. The WTC account was created in December 2001 so that Wilson could have a trading history if TWCO began a hedge fund.[32] The initial investment in the WTC account was approximately $400,000 or $500,000.

Wilson and Christian testified that Trautman made late trading decisions for the WTC account. At first, the WTC account followed or "mimicked" the trading strategy of Alastor, which made its trading decisions before 4:00 p.m. However, subsequently, Trautman, Wilson, and Christian decided to make a trade based on a post-4:00 p.m. earnings announcement. When the strategy proved profitable, they decided that thereafter they would make trading decisions for the WTC account based on post-4:00 p.m. market news, but still obtain the same day's NAV. Christian testified that he and Trautman had daily discussions about which companies were reporting earnings after 4:00 p.m. Wilson testified that Trautman "absolutely" was aware that late trading took place in the WTC account; that Trautman was in charge of trading instructions for the WTC account; that Trautman conferred with Christian regarding different market indicators before making the trading decisions; and that Wilson personally observed Trautman making post-4:00 p.m. trading decisions in the WTC account.[33]

Trautman admitted that he placed mutual fund orders in the WTC account that took advantage of "time arbitrage" trading. Trautman testified that he "regularly" visited Wilson's and Christian's office after 4:00 p.m. to "confirm what we were or were not doing" in the WTC account. Trautman recalled that he also discussed stock futures trading and the markets in

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[31] (...continued)
by contrast, the customer orders were placed with and transmitted by TWCO after the pricing time.

[32] Trautman testified that the account was called the Wilson Trautman Christian account "because the three of us were going to be involved in formulating the strategy and building the hedge fund platform."

[33] On one occasion when Trautman was unavailable, Wilson and Christian asked Wasserman to make the late trading decisions for the WTC account. According to Wilson, Wasserman demurred and told them that "that was Greg[] [Trautman's] responsibility."

general with Christian. Trautman testified that he generally "confirmed" trades for the WTC account at 5:30 p.m. or 6:00 p.m., after market moving information came out, that he "broadly" knew the day's NAV when he made his confirmations, and that he received a "stale price" (the same day's NAV) for the trades.[34] Trautman stated that he was asked to "confirm" trades in the WTC account "maybe a dozen times."

Augen. In December 2002, Trautman solicited Jeffrey Augen to open an account at TWCO to be used for late trading. Trautman informed Augen that he had a strategy of investing in mutual funds using a "trigger," *i.e.*, when the price of stock futures contracts rose by one and one-half percent in post-4:00 p.m. trading. Augen understood that Trautman's trading strategy permitted trading decisions up to 6:30 p.m., and that the trades would receive the price determined at 4:00 p.m. the same day.[35] Augen testified that Trautman represented that he had made money on thirteen out of fifteen trades using this strategy.

In or about January 2003, Augen and his wife opened a joint account at TWCO and invested $250,000. Augen testified that he decided to pursue Trautman's strategy because it had a two and one-half hour advantage after the markets closed, not typically available to public customers, that would enable Augen to buy mutual fund shares at the 4:00 p.m. price using information after the markets' close.

Augen and his wife testified that Trautman made the trading decisions for their TWCO account. They also testified that Trautman suggested that they give him discretion to trade the account so that Trautman did not have to obtain their approval for trades and could ensure that the Augens would be able to late trade on any given trading day. Augen closed the TWCO account in July 2003 because he was not sure that he agreed with Trautman's strategy and was losing money.

Trautman agreed that he had discussions with Augen that resulted in Augen investing money in a joint account at TWCO. However, Trautman did not recall the specifics of those discussions. Trautman acknowledged that he confirmed trades in the Augen account after 4:00 p.m. and that the "final confirmation time" was 5:30 p.m. or 6:30 p.m.

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[34] In 2004 sworn investigative testimony, Trautman denied that he ever placed a mutual fund order after 4:00 p.m. However, he did "remember cancelling an error after 4 o'clock, once, on a trade." Trautman also denied that he "personally" ever went long in mutual fund shares based on earnings announcements after 4:00 p.m.

[35] Augen testified that Trautman referred to his trading strategy as TWCO's "secret sauce." According to Augen, "there were two ingredients to the secret sauce. One ingredient [was] the relationship that allows them [TWCO] to sweep the money at 6:30 [p.m.] at night using the 4 o'clock price, the agreement with Bank of America. And the other ingredient would be the trigger that was used for it."

CIBC. CIBC invested three to four million dollars in an account at TWCO. Wilson testified that Trautman made the trading decisions for, and late traded in, the CIBC account. Trautman affirmed that he made trading decisions for the CIBC account. Trautman explained that Christian would call him to "confirm" an order and Trautman would "okay or reject" that order after 4:00 p.m.[36] Trautman affirmed that trades for the CIBC account were placed at the same time as those for the WTC account. Trautman testified that, in his mind, there was no distinction between the CIBC and WTC accounts.

Ritchie Capital. In March or April 2001, at Wilson's request, Trautman introduced Ritchie Capital to Janus Funds through his friend Warren Lammert, portfolio manager of the Janus Mercury Fund.[37] Trautman admitted that he understood that the purpose for making the introduction was to obtain market timing capacity for Ritchie Capital's TWCO account. However, Trautman denied that he understood at the time that TWCO's customers would use capacity obtained from the Janus Funds to engage in "time arbitrage" trading with "stale pricing."

The prospectus for the Janus Funds, including the Janus Mercury Fund, stated that "[a] fund's NAV is calculated at the close of the regular trading session of the NYSE (normally 4:00 p.m. New York time) each day that the NYSE is open. In order to receive a day's price, your order must be received by the close of the regular trading session of the NYSE." Trautman

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[36] When asked if he made trade confirmations or cancellations in the CIBC account at 5:30 p.m. or 6:30 p.m., Trautman replied, "I honestly don't recall ever doing it [post-4:00 p.m. confirmations or cancellations] for the CIBC account, although my testimony is not that I didn't. I think once it [the CIBC account] was set up to mimic the WTC account[,] to me[,] the calls were still the WTC account." As noted previously, the law judge did not credit Trautman's testimony.

[37] The Commission instituted and settled civil administrative proceedings against Janus Capital Management for allowing certain parties to conduct market timing in mutual funds it managed during the period from 2001 to 2003. *See Janus Capital Mgmt., LLC*, Investment Advisers Act Rel. No. 22771 (Aug. 18, 2004), 83 SEC Docket 2034. The Commission also brought administrative proceedings against Warren Lammert for his role in market timing transactions in the Janus Funds' mutual funds. A law judge found that Lammert was a cause of Janus Funds' violations of Securities Act Sections 17(a)(2) and 17(a)(3), Section 206(2) of the Investment Advisers Act of 1940, and Investment Company Act Section 34(b), and entered a cease-and-desist order against him. *See Warren Lammert*, Initial Decision Rel. No. 348 (Apr. 28, 2008), 93 SEC Docket 5676. We declared that decision final. *Warren Lammert*, Exchange Act Rel. No. 57882 (May 29, 2008), 93 SEC Docket 6185.

testified that he never reviewed any public documents issued by any of the mutual funds that TWCO traded.[38]

Despite the requirements in the prospectus, Trautman effected a $100 million late trade in the Janus Mercury Fund on behalf of Ritchie Capital. Christian testified that, one evening around 6:00 p.m., "there was a news event, the futures were rallying," and Ritchie Capital called and asked if it could move its money into the Janus Mercury Fund. Christian relayed Ritchie Capital's request to Trautman. Trautman, with Christian present, called Lammert and asked if Ritchie Capital could make the trade. Trautman testified that Lammert inquired, "[I]s that possible[?]," to which Trautman replied, "[Y]es, in our system we can put our orders up until 5:30 [p.m.] or 6:30 [p.m.]." Trautman testified that once he told Lammert "what our system was capable of doing," Lammert said that the trade "wouldn't be a problem." Trautman informed Christian that it was "okay" with Lammert. At Trautman's direction, Christian entered an order on Ritchie Capital's behalf for $100 million. Christian affirmed that Ritchie Capital received the price calculated at 4:00 p.m. that day, even though the trading decision was made after the 4:00 p.m. pricing time.

2. Trautman Deceptively Negotiated and Secured Market Timing Capacity

As discussed, "capacity" in the mutual fund market timing business was the ability to gain access to mutual funds and to be allowed to freely market time the funds. Christian testified that obtaining market timing capacity was important because it allowed TWCO to "grow" its assets by bringing in new business with customers.[39] It also allowed TWCO to market time "freely" in the funds without having to open multiple accounts and without receiving "kick-out" letters. TWCO developed a list of mutual funds that gave it capacity and allowed it to market time the funds. TWCO used the capacity it obtained for late trading.

TWCO's partners, including Trautman, participated in Wilson's and Christian's efforts to obtain capacity from mutual funds. Christian testified that he expected that capacity obtained by TWCO's partners would be used for late trading. Christian also testified that at meetings he attended TWCO's partners sought to secure capacity from mutual funds by representing that TWCO's style of market timing was beneficial and not harmful to the funds.

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[38] Prospectuses are public documents issued by mutual funds. *In re Merrill Lynch & Co., Research Reports Sec. Litig.*, 272 F. Supp. 2d 243, 247 n.2 (S.D.N.Y. 2003) (finding that fund prospectus was properly considered in determining motion to dismiss because it was a public document and was filed with the SEC).

[39] TWCO earned fees from its customers based on the amount of assets held under management. Generally speaking, the more assets that TWCO had under management, the greater the revenues generated for the firm.

Alliance Technology Fund. Christian testified that TWCO's customers market timed approximately $90 million in the Alliance Technology Fund.[40] TWCO conducted late trading in the Alliance Technology Fund for Beacon Rock, Pentagon Capital, and Ritchie Capital. TWCO's customers did not trade frequently in the Alliance Technology Fund, but were able to trade the fund profitably because they were trading on earnings announcements and news events that occurred after 4:00 p.m.

In the spring of 2003, the Alliance Technology Fund decided to no longer permit market timing in that fund. Christian and Wilson were concerned about the loss of timing capacity due to TWCO's "huge investment" in the Alliance Technology Fund. Using Wasserman's close relationship with an Alliance executive, Trautman and Christian arranged a meeting in May 2003 with Alliance Technology Fund's portfolio manager, Gerald Malone, in order to seek an exception and to continue market timing the funds.

Although Trautman was aware that TWCO's customers market timed and late traded the Alliance Technology Fund, at the meeting he falsely informed Malone that TWCO's customers did not trade frequently in the Alliance Technology Fund and conducted their trading in a way that was helpful to the fund's management. Trautman and Christian did not disclose to Malone that TWCO's practice was to trade after hours in the Alliance Technology Fund and obtain the same day's price for the trades.

After the meeting, Trautman wrote Malone a follow-up e-mail reiterating his claims that TWCO's trading in the Alliance Technology Fund was beneficial and seeking permission to remain in the Fund. Trautman also thanked Malone for "consider[ing] the possibility of figuring out a way to work together." Again, Trautman did not disclose to Malone that TWCO engaged in late trading in the Alliance Technology Fund.

Federated Funds. In the summer of 2003, TWCO sought capacity from representatives of Federated Funds. Trautman and other TWCO personnel, including Wilson and Christian, asserted to Federated Funds that TWCO's trading activities could benefit Federated Funds. In an e-mail, Federated Funds' James Power Gordon, Jr. rejected TWCO's arguments for capacity. Gordon concluded that market timing had a negative impact on mutual fund returns and could be harmful to the funds. In a responsive e-mail, Trautman indicated that he thought that Gordon's analysis overstated the long-term impact of market timing on mutual funds. Trautman also stated that TWCO did not consider its mutual fund trading to be market timing. Trautman further argued that TWCO's approach to mutual fund trading, which included providing "an extra

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[40] The Commission instituted and settled civil administrative proceedings against Alliance Capital Management for certain market timing trading activities in the Alliance mutual fund complex during 2001 to 2003. *See Alliance Capital Mgmt., LLC*, Investment Advisers Act Rel. 2205A (Jan. 15, 2004), 81 SEC Docket 4221.

cushion to the [portfolio] manager," would "create[] a positive for all sides."[41] Trautman did not disclose in his communications to Federated Funds that TWCO and its customers were using capacity to engage in late trading. Federated Funds gave capacity to TWCO to trade its funds.[42] TWCO was unable to use the capacity obtained from Federated Funds due to the onset of the NYAG's mutual fund trading investigation.

3. Trautman Made False Representations Regarding the Legality of the Late Trading

Beacon Rock. In early 2002, Christian and Wilson met with Beacon Rock to offer Beacon Rock access to TWCO's late trading platform. Beacon Rock indicated that it might be interested in investing $100 to $200 million with TWCO to pursue the late trading strategy. Christian conveyed this information to Trautman. In March 2002, Beacon Rock opened an account at TWCO. By the end of May 2002, Beacon Rock had invested $63.6 million with TWCO. As stated previously, all of Beacon Rock's trades through TWCO were late trades.

In July 2002, Blake Singer, a Beacon Rock principal, and Kelly Hollingsworth, Singer's independent consultant, met with Trautman, Wasserman, Wilson, and Christian at TWCO's offices. Singer stated that he and Hollingsworth wanted to get more comfortable with TWCO's late trading platform. The uniform testimony of Wilson, Christian, and Hollingsworth was that the meeting concerned TWCO's late trading.[43]

Hollingsworth testified that during the meeting TWCO personnel focused mainly on the mechanics of the late trading, prompting her to remark that this "tells [her] why the trad[ing] is possible, but it doesn't explain to [her] why the trad[ing] is legal." According to Hollingsworth, Trautman represented that TWCO's internal compliance department and outside counsel had

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41 Trautman's e-mail stated, in part, that, "[f]orgetting for a second that we [TWCO] do not consider our activity to be 'market timing,'' the "long term impact [on mutual funds] of a number of short term trades actually approache[d] a negligible number." The e-mail suggested that "even a negligible impact" could be a "positive" that would "help[,] [and not] hurt[,] [Federated Funds'] performance."

42 The Commission instituted and settled civil administrative proceedings against Federated Funds for its late trading and deceptive market timing activities in 2003 and earlier years. *See Federated Inv. Mgmt. Co.*, Exchange Act Rel. No. 52839 (Nov. 28, 2005), 86 SEC Docket 2441.

43 Singer did not testify at the hearing.

reviewed the late trading, leading her to believe that TWCO's late trading had been approved by both and was legal.[44]

In addition, Christian testified that Trautman specifically stated at the meeting that BOA's system provided the opportunity after 4:00 p.m. to cancel, change, or amend orders placed before 4:00 p.m.; that this was an "operational loophole" in the system; and that he, Trautman, did not have an issue with a customer confirming an order previously submitted before 4:00 p.m. because it was a function of the system.

Trautman denied that Singer and Hollingsworth specifically asked about the legality of placing a mutual fund order before 4:00 p.m and then cancelling or confirming the order after 4:00 p.m, although he admitted that their questions "encompassed" that activity. Trautman also denied that he falsely represented that TWCO had consulted with outside counsel concerning the legality of the trading. The law judge credited Hollingsworth's version of events because, as stated previously, she found that Trautman's testimony was often "inconsistent and/or false."

Following the July 2002 meeting, Beacon Rock continued to late trade through TWCO. At a subsequent meeting in March 2003, Singer informed Wilson, Christian, and Wasserman of Beacon Rock's plan to raise significantly more money to pursue the late trading strategy through TWCO.

Augen. Augen testified that Trautman represented that late trading was a "common practice" among Wall Street investment bankers, done through agreements between banks (specifically referring to TWCO's relationship with BOA), and was "completely legal."

4. Trautman Sought to Continue Some Late Trading After TWCO Received a Subpoena

In August 2003, after TWCO received a subpoena from the NYAG regarding its mutual fund trading, Wilson and Trautman discussed TWCO's late trading and Trautman indicated that TWCO might have violated the securities laws. Wilson testified that he believed that Trautman was "panicked" due to the "massive amount of income" that potentially would be lost if TWCO's customers could not late trade.

Wilson testified that he and Trautman discussed how TWCO could continue late trading for Ritchie Capital, the firm's most "sophisticated" customer and largest account. Christian

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[44] During oral argument, Trautman's counsel represented that Wasserman testified that "that [Hollingsworth's version of the meeting] never happened." The record shows that at the hearing, Wasserman admitted that Singer asked about late trading. However, Wasserman testified that "[t]he late trading that he [Singer] was asking to be done in my mind . . . had nothing to do with when you would make a decision, but it was entering orders from an operational point of view, could that be done after the [markets'] close."

testified that Trautman was "fearful" that Ritchie Capital would "take [its] assets back" because it could no longer late trade through TWCO. Trautman indicated that he "couldn't run the firm" if, in the coming weeks, the income generated by Ritchie Capital's account was "going to disappear." In an attempt at damage control, Christian testified that Trautman came up with the idea of "optics" as a way to continue some late trading for Ritchie Capital but conceal it from the regulators. According to Christian, Trautman used the word "optics" to mean "how things were going to appear" to the regulators.

Ritchie Capital ceased late trading through TWCO, despite Trautman's efforts. Ritchie Capital agreed to a 4:00 p.m. cut-off time for its mutual fund trading in exchange for reduced management fees charged by TWCO. Thereafter, the NYAG publicly announced its investigation into mutual fund trading. "[A]t that point[,]" Christian testified, "we knew everything was done."

G. TWCO's Revenues from the Scheme

Wilson testified that he regularly discussed the profitability of TWCO's mutual fund department with TWCO's partners, including Trautman, and that they knew of and were excited about its successes.[45] Trautman affirmed that he knew that Wilson and Christian generated a "substantial amount of revenue" for the firm. Trautman also knew that Wilson's business was "very successful" and grew to be "very large."

Commission staff examiners and the Division's expert calculated that for the years 2001, 2002, and the first nine months of 2003, TWCO had gross revenues of approximately $32.5 million, including approximately $22.6 or $22.7 million in mutual fund revenues.[46] TWCO's mutual fund revenues thus accounted for approximately seventy percent of its gross revenues during the relevant period. After paying Wilson and Christian,[47] TWCO received forty percent of the $22.6 million in mutual fund revenues, or approximately $9,040,000. The $9,040,000 was

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[45] Wilson testified that he and TWCO's partners engaged in "friendly bantering" regarding "the profitability of the [mutual fund] department and how much money was coming in." Wilson stated that there were times when he joked that his business was "keeping the lights on" at the firm.

[46] The record does not explain the reason for the discrepancy between the $22.6 and $22.7 million figures. For purposes of this opinion, we use the $22.6 million figure.

[47] Wilson received sixty percent of the mutual fund revenues minus a portion of prorated expenses. Wilson's compensation was approximately $1.4 million in 2001, $5.5 million in 2002, and $3.5 million in 2003, for a total of approximately $10.4 million. Christian received a salary of $36,000 and medical benefits from TWCO, as well as a percentage of Wilson's share of the mutual fund revenues. Christian's compensation was $210,624 in 2001, $740,125 in 2002, and $884,019 in 2003, for a total of approximately $1.8 million.

invested in TWCO, TW Holding Company,[48] and the private equity companies advised by the firm; the partners received salaries but no bonuses. TWCO CFO Barbara testified that the "vast majority" of the firm's mutual fund revenues was used not only to fund business operations but also to pay for expenses such as salaries, overhead, health benefits, and rent.

A comparison of TWCO's mutual fund revenues with its gross revenues for 2001 to 2005 is set forth below:

Year	Mutual Fund Revenues	Gross Revenues
2001	5,769,120	8,492,975
2002	9,955,909	13,267,450
2003	8,841,213	12,284,437
2004	2,042,163	6,548,211
2005	882,798	4,801,212

TWCO's mutual fund revenues declined following New York state and federal regulatory investigations into misconduct in the trading of mutual fund shares, beginning in September 2003.

In his affidavit, the Division of Enforcement's expert concluded that "market timing and specifically late trading strategies most likely generated the orders for most of" TWCO's trades between 2001 and 2003. The expert based this conclusion on the short periods between purchases and subsequent sales and on the strong correlations between purchases and subsequent price increases.[49] The expert further concluded that TWCO's customers' trading was "extraordinarily successful" because mutual fund prices rose on the day following approximately sixty percent of their purchases but fell following only nearly thirty-four percent of the purchases. (Prices did not change on the remaining six percent of purchases.) The expert found that TWCO's trading caused approximately $102.7 million in dilution losses to mutual funds and their shareholders.

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[48] Wasserman testified that TWCO's portion of the mutual fund revenues may have been used to pay debts of TW Holding Company, which was 100% owned by Trautman.

[49] The expert calculated that the average trade size was $535,134 and that customers began to sell fifty percent of the positions they purchased within two trading days of purchase and sold ninety percent within eight trading days. The expert opined that the frequent trading and short holding periods were characteristic of the execution of market timing and late trading strategies.

III.

A. Trautman's Primary Liability

The OIP charged Trautman with primary violations of the antifraud provisions of the securities laws -- Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5 -- based on his participation in TWCO's late trading and deceptive market timing scheme. Securities Act Section 17(a), which proscribes fraudulent conduct in the offer or sale of securities, and Exchange Act Section 10(b) and Exchange Act Rule 10b-5, which proscribe fraudulent conduct in connection with the purchase or sale of securities, prohibit essentially the same type of conduct.[50] To find Trautman primarily liable under Securities Act Section 17(a)(1), Exchange Act Section 10(b), and Exchange Act Rule 10b-5, it must be shown that Trautman engaged in fraudulent conduct, that such conduct was in connection with the offer, sale, or purchase of securities,[51] and that he acted with scienter.[52] Scienter is not required to prove a violation of Securities Act Sections 17(a)(2) and 17(a)(3); instead, a showing of negligence is sufficient.[53]

1. Trautman's Fraudulent Conduct

To establish that Trautman engaged in fraudulent conduct, he must have: (1) made an untrue statement of material fact;[54] (2) omitted a fact that made a prior statement misleading; or

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[50] *See United States v. Naftalin*, 441 U.S. 768, 778 (1979); *see also, e.g., SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996), *cert. denied*, 522 U.S. 512 (1997).

[51] The United States Supreme Court has embraced an expansive interpretation of Exchange Act Section 10(b)'s "in connection with" language and Securities Act Section 17(a)'s "in the offer or sale" language. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006); *SEC v. Zandford*, 535 U.S. 813, 819 (2002); *Naftalin*, 441 U.S. at 773. Trautman does not dispute that those requirements have been met.

[52] *SEC v. Tambone*, 417 F. Supp. 2d 127, 131 (D. Mass. 2006) (citing *Aaron v. SEC*, 446 U.S. 680, 695 (1980) and *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976)).

[53] *Aaron*, 446 U.S. at 697 & 701-02; *Weiss v. SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006).

[54] A fact is material if there is a substantial likelihood that a reasonable investor would have considered the misstated or omitted fact important in making an investment decision, and if disclosure of the misstated or omitted fact would have significantly altered the total mix of information available to the investor. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

(3) committed a deceptive or manipulative act as part of a scheme to defraud.[55] Late trading in mutual funds is a scheme to defraud.[56] Mutual funds are defrauded into believing that trades were submitted before the 4:00 p.m. close of regular trading when, in fact, they were submitted with the benefit of market moving information after the 4:00 p.m. close, thereby causing funds to provide improper prices for the trades.[57]

Trautman committed primary violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5 based on his knowing or reckless participation in a fraudulent scheme. Trautman, as TWCO's co-owner, president, and chief executive officer, engaged in numerous deceptive acts as part of the scheme. Trautman personally engaged in the late trading; deceptively sought market timing capacity from Alliance Technology Fund and Federated Funds by materially misrepresenting the nature of TWCO's trading and its impact on the funds; and fraudulently induced Beacon Rock and Augen to invest or to continue investing with TWCO by falsely assuring them of the legality of the late trading, all in furtherance of the late trading aspect of the scheme.[58]

Trautman personally engaged in the late trading. Trautman admitted that he made trading decisions for the WTC, Augen, and CIBC accounts at 5:30 p.m. or 6:30 p.m., using post-4:00

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[55] *Tambone*, 417 F. Supp. 2d at 131-32. *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 769 (2008) (stating that it would be "erroneous" to suggest that "there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5"; emphasizing that "[c]onduct itself can be deceptive"); *see also Burnett v. Rowzee*, 561 F. Supp. 2d 1120, 1125 (C.D. Cal. 2008) (stating that under a theory of scheme liability, "relevant deceptive acts include[] deception as part of a larger scheme to defraud the securities market"; further, a deceptive act is one that has "the principle purpose and effect of creating a false appearance of fact in furtherance of the scheme") (internal quotations and citations omitted).

[56] *See In re Mut. Funds Inv. Litig*, 384 F. Supp. 2d at 856 & n.10.

[57] *See Simpson Capital Mgmt.*, 586 F. Supp. 2d at 204-05 (denying motion to dismiss complaint alleging late trading scheme in violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5; complaint sufficiently alleged that defendants engaged in "deceptive conduct" where their acts communicated the "false impression" to mutual funds that trades were submitted before 4:00 p.m. when, in fact, they were submitted with the benefit of market news after 4:00 p.m.).

[58] *See United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008) (observing that "deceptive conduct" within the meaning of Exchange Act Section 10(b) "irreducibly entails some act that gives . . . a false impression"); *see also SEC v. Dorozhko*, 574 F.3d 42, 50 (2d Cir. 2009) (stating that, "[i]n its ordinary meaning, 'deceptive' covers a wide spectrum of conduct involving cheating or trading in falsehoods").

p.m. market information, and that he obtained a "stale price" for the trades. At Trautman's direction, TWCO personnel entered Trautman's trades into BOA's system as though they were received before 4:00 p.m. Trautman acknowledged that, at least with respect to the WTC account, he effected post-4:00 p.m. trades "maybe a dozen times." Trautman further acknowledged that, on behalf of Ritchie Capital, he arranged a $100 million trade in the Janus Mercury Funds after 4:00 p.m. Trautman effected the $100 million trade even though Janus Mercury Fund's prospectus required that orders had to be received by the 4:00 p.m. close of trading on the NYSE in order to obtain the same day's NAV. Christian affirmed that he entered the $100 million trade for processing after 4:00 p.m. and that Ritchie Capital obtained the same day's NAV for the trade. The submission of mutual fund trades after the 4:00 p.m. close of trading constituted materially false representations that the trades were received by TWCO before 4:00 p.m., where those trades received the same day's NAV.[59] By directing TWCO to enter the mutual fund trades effected after 4:00 p.m. as if they actually were received before 4:00 p.m., Trautman deceived mutual funds into providing improper prices for the trades.

Trautman materially misrepresented the nature of TWCO's trading and its impact on mutual funds when he sought to obtain market timing capacity from Alliance Technology Fund and Federated Funds. Trautman falsely stated to Federated Funds that TWCO did not consider its mutual fund trading to be market timing, despite the fact that TWCO's primary trading strategies involved market timing. Trautman also falsely characterized TWCO's trading as beneficial to Alliance Technology Fund and Federated Funds when, in fact, he knew that TWCO used capacity obtained from funds to engage in late trading, which harmed the funds by diluting the value of their shareholders' investment.[60] By materially misrepresenting the nature of TWCO's trading and its impact on the mutual funds, Trautman sought to evade mutual funds' anti-market timing restrictions and conceal TWCO's late trading from the funds.[61] That this

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[59] The misrepresentations were material because a reasonable investor would have considered it important to know whether and to what extent the daily NAV of a particular mutual fund was diluted by late trading.

[60] *See SEC v. Druffner*, 517 F. Supp. 2d 502, 508 (D. Mass. 2007) (granting Commission's motion for summary judgment in enforcement action against stock broker for engaging in market timing activities through false statements and intentional misrepresentations in violation of federal securities laws' antifraud provisions; finding that defendant materially misrepresented the nature of his and brokerage team's transactions to mutual funds through use of fictitious financial advisor numbers and accounts, with intent to evade detection by mutual fund managers), *aff'd sub nom. SEC v. Ficken,* 546 F.3d 45 (1st Cir. 2008).

[61] Trautman's false statements regarding the nature of TWCO's trading and its impact on the mutual funds were material because a reasonable investor would have wanted to know that the firm and its customers were using market timing capacity and engaging in unlawful late trading.

objective was achieved is reflected in part by Federated Funds' agreement to give TWCO capacity and allow TWCO to market time its funds.[62]

Trautman fraudulently induced customers to invest or to continue investing with TWCO by falsely assuring them of the legality of the late trading, an activity that was a selling point for the firm. Trautman's business strategy for TWCO required customers' continued investment with the firm and participation in the trading. Trautman's false assurances to customers furthered the deceptive scheme by encouraging them to continue investing more money with TWCO in order to pursue the late trading strategy.

Trautman falsely represented to Beacon Rock's Singer and Hollingsworth that TWCO's late trading had been reviewed by outside counsel and internal compliance when there were no legal or compliance opinions that supported the firm's late trading. Trautman also falsely stated to Singer and Hollingsworth that the late trading was permissible because of an "operational loophole" in BOA's system, despite the fact that, pursuant to BOA's mutual fund processing manual, mutual fund orders had to be received by TWCO before 4:00 p.m. in order to receive the same day's NAV. Based on Trautman's false statements, Beacon Rock continued to late trade through TWCO and determined to invest more money with TWCO to pursue the late trading strategy.

Trautman falsely stated to Augen that the opportunity to buy mutual fund shares at the 4:00 p.m. price, using market information after 4:00 p.m., was possible because of TWCO's relationship with BOA and was "completely legal." However, Trautman obtained no legal analysis from inside or outside TWCO to support the firm's late trading operations. Based on Trautman's false statements, Augen invested $250,000 in a joint account at TWCO. Trautman's purpose in making material misrepresentations to Augen and Beacon Rock was to further the late trading scheme.[63]

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[62] That TWCO was unable to use the capacity obtained from Federated Funds due to the onset of the NYAG's mutual fund trading investigation is of no moment here. An action brought by the Commission, unlike a private damage suit, need not include proof of harm. *See Graham v. SEC*, 222 F.3d 994, 1001 n.15 (D.C. Cir. 2000); *Schellenbach v. SEC*, 989 F.2d 907, 913 (7th Cir. 1993); *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985).

[63] Trautman's misrepresentations were material because a reasonable investor would have considered the illegality of the late trading to be an important factor in deciding whether to invest or to continue investing with TWCO.

2. Trautman's Scienter

Trautman acted with scienter. Scienter is a mental state embracing an intent to deceive, manipulate, or defraud.[64] It includes recklessness, defined in this context as "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the [respondent] or so obvious that the [respondent] must have been aware of it."[65]

Trautman knew that TWCO's mutual fund department regularly engaged in market timing and, specifically, late trading activities, and admitted that it had been doing so for "several years." Trautman had frequent discussions with Wilson and/or Christian about TWCO's late trading. Trautman admitted that he knew that customers generally placed orders before 4:00 p.m. on any given trading day, and then confirmed or cancelled those orders after 4:00 p.m., up until 6:30 p.m., at which point TWCO personnel entered them into the system for processing. Trautman understood that the benefit to customers in submitting trading instructions after 4:00 p.m. was that they had more time than the rest of the market to make their trading decisions and were able benefit from information that became available after 4:00 p.m. Trautman also understood that by engaging in such trading, TWCO customers were able to take advantage of "stale prices" on their trades. Trautman further understood that TWCO's mutual fund department was "very successful" and generated substantial revenues for the firm.

Trautman not only knew of TWCO's late trading activities, but he also observed them taking place. Wilson testified that Trautman was present in his and Christian's office, often sitting in Wilson's chair, as customers' mutual fund orders came in after 4:00 p.m. Trautman admitted that he regularly visited Wilson's and Christian's office at 6:00 p.m. or 6:30 p.m. when, by all accounts, customers' mutual fund orders were received and entered.

Furthermore, Trautman personally engaged in the late trading. Trautman admitted that he made trading decisions for the WTC, Augen, and CIBC accounts based on post-4:00 p.m. market information, knowing that TWCO would obtain a "stale price" for the trades. Trautman recalled discussing post-4:00 p.m. trading in the futures markets with Christian before making his trading decisions. Trautman also admitted that he effected a $100 million late trade in the Janus Mercury Fund on behalf of Ritchie Capital. Trautman directed Christian to enter the $100 million trade after 4:00 p.m., knowing that Ritchie Capital would receive the NAV calculated as of 4:00 p.m. that day, in contravention of the prospectus requirement.

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[64] *Ernst & Ernst*, 425 U.S. at 193 n.12.

[65] *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 704 (7th Cir. 2008) (quoting *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 76 (2d Cir. 2001)); *see also, e.g., SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (quoting *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977)). Proof of scienter may be demonstrated by circumstantial evidence. *Herman & Maclean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983); *Valicenti Advisory Servs., Inc. v. SEC,* 198 F.3d 62, 65 (2d Cir. 1999).

Trautman knew, or was reckless in not knowing, that the late trading that he and TWCO engaged in was illegal. BOA's instruction manual and the prospectuses of many mutual funds which Trautman and TWCO traded required that mutual fund orders be received before 4:00 p.m. in order to obtain that day's NAV. While Trautman claimed that he never saw BOA's manual and never read the public documents of any mutual funds, those materials provided clear notice of what was required for an investor to receive the current day's NAV. At a minimum, Trautman recklessly turned a blind eye to those requirements. In doing so, his conduct constituted "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to [Trautman] or so obvious that [Trautman] must have been aware of it."[66]

Trautman testified that he knew that market timing strategies could be harmful to mutual funds. Trautman understood that the "undisclosed and unanticipated rapid buying and selling of securities in a small fund or an illiquid fund could be harmful to the fund manager's ability to manage his portfolio positions." Trautman also understood that there were "bad" market timers who "trade[d] hundreds of times a year or trade[d] in and out [of mutual funds] without the fund managers knowing." Trautman further understood that mutual funds sought to prevent or restrict market timing and took measures against known market timers.

Trautman testified that he heard from Wilson, Christian, and another individual that there were legal opinions or Commission no-action letters ostensibly supporting TWCO's late trading operations. However, Trautman made no attempt to obtain and/or read any legal opinions or Commission no-action letters. In fact, Trautman knew that there was substantial doubt about the legality of TWCO's late trading because it was the subject of numerous conversations of which he was a part. Christian testified that, with Trautman present, he and Wilson had discussions about the "legal/illegal" aspect of TWCO's late trading. Christian testified that the three of them attributed TWCO's ability to late trade to an "operational loophole" in BOA's system, in order to "justify" the trading to themselves.

Trautman's knowledge that there were at least substantial questions about the legality of TWCO's late trading did not prevent him from falsely representing to customers that the late trading was proper and legal. As discussed, Trautman represented to Beacon Rock's Singer and Hollingsworth that both outside counsel and internal compliance had reviewed the practice of late trading. Trautman told Augen that TWCO's late trading ability was due to its relationship with BOA and was "completely legal." By his own admission, however, Trautman did not consult with counsel, compliance, or anyone else regarding the propriety of TWCO's late trading. Trautman's failure to follow-up and investigate the propriety of the late trading in the face of substantial doubt as to its legality constituted at least recklessness.

Even after the NYAG issued a subpoena to TWCO in August 2003 and Trautman indicated to Wilson that TWCO might have acted illegally, Trautman suggested continuing the

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[66] *Makor Issues & Rights*, 513 F.3d at 704.

late trading for Ritchie Capital on a limited basis. Trautman's actions in urging that Ritchie Capital continue some late trading, but conceal it from the regulators through "optics" that would hide post-4:00 p.m. trades, is compelling evidence that he acted at all times with a high degree of scienter.

Given his extensive experience in the securities industry and numerous securities licenses, his position as co-founder, president, and chief executive officer of a small firm that earned approximately seventy percent of its gross revenues during the relevant period from mutual fund trading, and his direct, hands-on management of all aspects of the firm's operations, Trautman must have known that illegal late trading was taking place at TWCO. We find that Trautman is primarily liable for his active and intimate involvement in the scheme,[67] which generated more than $22 million in mutual fund revenues for TWCO between 2001 and 2003. We conclude that Trautman willfully[68] violated Securities Act Section 17(a)(1), Exchange Act Section 10(b), and Exchange Act Rule 10b-5.[69]

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[67] *See, e.g., Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 859-60 & n.3 (holding that allegations of defendants' role in alleged late trading scheme as its creators, directors and chief beneficiaries were sufficient to subject defendants to primary antifraud liability and survived motion to dismiss complaint; stating that "the allegations that Defendants here were the architects of the alleged scheme are sufficient, but not necessary, to plead liability as primary violators of the securities laws"); *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 858 (holding that defendants alleged to have been involved in fraudulent scheme from the outset, to have been at least one of its architects, and to have received profits that were siphoned off of mutual funds as a result of late trades and market timed transactions were subject to primary antifraud liability); *In re Blech Sec. Litig.*, 961 F. Supp. 569, 585-86 (S.D.N.Y. 1997) (holding that a claim for primary liability under Exchange Act Section 10(b) was sufficiently stated where plaintiff alleged that defendant "directed," "contrived," and participated in the initiation and clearing stages of certain alleged fraudulent transactions); *see also, e.g., SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 112 (2d Cir. 1998) (holding that stock trader could be primarily liable under Exchange Act Section 10(b) for following stock promoter's directions to execute trades that trader knew, or was reckless in not knowing, were manipulative, even if he did not share promoter's overall purpose to manipulate the market for that stock; finding that trader personally committed manipulative acts when he effected the very buy and sell orders that artificially manipulated the stock price upward).

[68] A willful violation of the securities laws means the intentional commission of an act that constitutes the violation; there is no requirement that the actor must be aware that he is violating any statutes or regulations. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

[69] We reject Trautman's claim, made in reliance on *Upton v. SEC*, 75 F.3d 92 (2d Cir. 1996), that our interpretation of late trading violates due process because he did not have fair notice that his conduct would constitute regulatory violations. "Due process requires . . . only
(continued...)

Trautman claimed that he thought that the late trading was legal because he "broad[ly]" understood that mutual funds calculated and publicly posted their NAVs around 6:00 p.m. or 6:30 p.m. According to Trautman, because TWCO's customers usually placed their orders by 5:30 p.m. or 6:30 p.m., before the public posting of NAVs, those orders properly received the NAVs calculated at 4:00 p.m. that day. However, if, as Trautman claimed, there was a lawful time between 4:00 p.m. and the public posting of NAVs to submit orders, then presumably TWCO would have implemented procedures to keep track of the times when NAVs were publicly posted and orders were submitted, and TWCO or Trautman would have maintained documents that evidenced those procedures. Not surprisingly, the record shows that no such procedures were in place and that no such documents were produced. Indeed, Trautman admitted that he did not know of any system at TWCO that either tracked when the funds' NAVs were made public or indicated whether customers' confirmations and cancellations were made before NAVs were posted. Furthermore, the testimony of mutual fund representatives established that, while the actual calculation and public posting of NAVs could occur one or two hours after the close of the markets at 4:00 p.m., all mutual fund trading orders had to be received by a mutual fund's intermediary by 4:00 p.m. in order to obtain that day's NAV.

B. Trautman's Secondary Liability

In addition to charging that Trautman willfully violated Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5, the OIP charged that Trautman willfully aided and abetted, and was a cause of, TWCO's violations of Exchange Act Section 15(c) and Exchange Act Section 10b-3, which prohibit broker-dealers from effecting transactions in, or inducing or attempting to induce, the purchase or sale of securities by means of a manipulative, deceptive, or other fraudulent device or contrivance.[70]

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[69] (...continued)
that 'laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited.'" *Valicenti Advisory Servs.*, 198 F.3d at 66 (quoting *Upton*, 75 F.3d at 98). Trautman, an experienced securities professional, cannot "credibly claim lack of fair notice of the proscription against defrauding investors." *Id.*

We also reject Trautman's claim, made in his petition for review, that the law judge's "surprise use of uncharged facts" constituted an "impermissible amendment of the OIP without the required notice" to him. Our review of the record reveals that there was no "surprise use" of "uncharged facts," and that the OIP was not amended at any time. We find that throughout these proceedings the law judge acted consistently with our Rules of Practice and due process requirements.

[70] The scienter standards that apply to violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5 also apply to violations of Exchange Act Section 15(c)(1) and Exchange Act Rule 10b-3. *See, e.g., Darvin v. Bache Halsey Stuart*
(continued...)

The elements of aiding and abetting liability are: (1) a securities law violation by another party; (2) the alleged aider and abetter generally was aware or knew that his actions were part of an overall course of conduct that was improper or illegal; and (3) the alleged aider and abettor substantially assisted in the primary violation.[71] We have held that recklessness is sufficient to satisfy the scienter requirement for aiding and abetting liability.[72]

TWCO committed primary violations of Exchange Act Section 15(c) and Exchange Act Rule 10b-3. The record shows that TWCO engaged in a scheme to defraud mutual funds and their shareholders through late trading and deceptive market timing. As discussed, Wilson and Christian admitted that, while at TWCO, they engaged in late trading and deceptive market timing activities, thereby defrauding mutual funds and their shareholders.

Trautman, as TWCO's president and chief executive officer, substantially assisted in the firm's primary violations. Trautman was a hands-on manager who left his "fingerprints" on all aspects of the firm's operations. Trautman agreed to TWCO's hiring of Wilson and Christian and its establishment of a mutual fund market timing department. Trautman regularly met with Wilson and Christian several times a week and discussed their market timing strategies. As discussed, Trautman acknowledged that the revenues that Wilson and Christian generated were "substantial," in fact accounting for seventy percent of TWCO's gross revenues during the relevant period. Trautman was present when late trading occurred and personally made late trading decisions in the WTC, Augen, CIBC, and Ritchie Capital accounts.

In addition, Trautman deceptively sought market timing capacity from Alliance Technology Fund and Federated Funds by falsely characterizing TWCO's trading activities as not market timing and as beneficial to the funds. Furthermore, Trautman falsely assured Beacon

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[70] (...continued)
Shields, Inc., 479 F. Supp. 460, 464 (S.D.N.Y. 1979); *Fundamental Portfolio Advisors, Inc.*, 56 S.E.C. 651, 670 & n.35 (2003).

[71] *See, e.g., Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004); *Graham*, 222 F.3d at 1000; *Monetta Fin. Servs., Inc. v. SEC*, 390 F.3d 952, 956 (7th Cir. 2004); *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990). A person cannot escape aiding and abetting liability by claiming ignorance of the federal securities laws. *See Sharon M. Graham*, 53 S.E.C. 1072, 1084 n.33 (1998), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000).

[72] *See Graham*, 53 S.E.C. at 1080-85 & n.33; *Russo Sec., Inc.*, 53 S.E.C. 271, 278-79 & n.16 (1997). The District of Columbia Circuit Court of Appeals has held that "extreme recklessness" may support aiding and abetting liability "if the alleged aider and abettor encountered red flags or suspicious events creating reasons for doubt that should have alerted him to the improper conduct of the primary violator, or if there was a danger so obvious that the alleged aider and abettor must have been aware of it." *Howard*, 376 F.3d at 1143 (internal quotations and citations omitted).

Rock and Augen regarding the legality of the late trading so that they would invest or continue to invest their assets with and trade through TWCO.[73] Our findings with respect to Trautman's scienter in the context of his primary liability establish that he had the requisite knowledge that his actions were part of an overall course of conduct that was improper or illegal, as required for secondary liability. We conclude that Trautman willfully aided and abetted, and was a cause of,[74] TWCO's primary violations of Exchange Act Section 15(c) and Exchange Act Rule 10b-3.[75]

IV.

A. Statute of Limitations

As an initial matter, we note that the OIP issued on February 5, 2007. The five-year statute of limitations set forth in 28 U.S.C. § 2462 commenced on February 5, 2002.[76] Section 2462 precludes our consideration of Trautman's conduct occurring before February 5, 2002 in determining whether to impose a bar or civil penalty.[77] Such conduct may be considered, however, to establish Trautman's motive, intent, or knowledge in committing violations that are

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[73] Trautman's actions were a substantial factor in causing TWCO's primary violations and therefore satisfy the Second Circuit Court of Appeals' proximate cause requirement for the "substantial assistance" element of aiding and abetting liability. *See, e.g.*, *Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 266; *SEC v. Treadway*, 430 F. Supp. 2d 293, 339 (S.D.N.Y. 2006). We note, however, that the District of Columbia Circuit Court of Appeals has not adopted a proximate cause requirement. *See SEC v. Johnson*, 530 F. Supp. 2d 296, 303 n.7 (D.D.C. 2008).

[74] One who aids and abets a violation also is a cause of the violation under the federal securities laws. *See Graham*, 53 S.E.C. at 1085 n.35.

[75] In light of our findings of primary and secondary liability under the antifraud provisions of the securities laws, *see generally* 6 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation*, § 20.5 (6th ed. 2009) (stating that "[e]ven in the absence of an express rule prohibiting late trading, the SEC has made clear that late trading is improper and violates the [antifraud provisions of the] securities laws"), we do not decide Trautman's secondary liability for aiding and abetting, and being a cause of, TWCO's clearing firm BOA's violations of Investment Company Act Rule 22c-1.

[76] *See Johnson v. SEC*, 87 F.3d 484, 492 (D.C. Cir. 1996) (holding that Section 2462's five-year limitations period applied to certain Commission administrative proceedings).

[77] *See Terry T. Steen*, 53 S.E.C. 618, 623-25 (1998).

within the limitations period.[78] Further, we may consider the entirety of Trautman's conduct in deciding whether to impose a cease-and-desist or disgorgement order because such an order operates prospectively and is not subject to Section 2462.[79]

B. Bar from Association

Exchange Act Section 15(b)(6) authorizes us to censure, place limitations on, suspend, or bar a person associated with a broker or dealer if we determine that the person has, among other things, willfully violated the federal securities laws and it is in the public interest to do so.[80] We have indicated that, in determining what sanction is in the public interest, we consider the factors in *Steadman v. SEC*.[81] Those factors include the egregiousness of a respondent's actions, the degree of scienter involved, the isolated or recurrent nature of the infraction, the recognition of the wrongful nature of the conduct, the sincerity of any assurances against future violations, and the likelihood that the respondent's occupation will present opportunities for future violations.[82] We have also stated that conduct that violates the antifraud provisions "is especially serious and subject to the severest sanctions."[83]

Trautman's conduct while associated with a broker-dealer was egregious. He participated in a late trading and deceptive market timing scheme that defrauded many mutual funds and their shareholders. The fraudulent scheme generated at least $22 million in illicit profits for TWCO and caused dilution losses to mutual fund shareholders of more than $102 million. As set forth above, Trautman's conduct demonstrated a high degree of scienter. Trautman's conduct was not an isolated incident, but a recurrent pattern that extended over a substantial period of time and stopped only after it was detected by regulators. He has not offered assurances against future violations, nor has he recognized that he committed serious antifraud violations. Trautman's provision of consulting services to unidentified companies raises questions about his potential to

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78 *Id.* at 624; *see also Joseph J. Barbato*, 53 S.E.C. 1259, 1278 (1999); *Graham*, 53 S.E.C. at 1089 n.47.

79 *See Edgar B. Alacan*, 57 S.E.C. 715, 743 (2004).

80 15 U.S.C. § 78o(b)(6).

81 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

82 *Id.*

83 *Justin F. Ficken*, Investment Adviser Act Rel. No. 2803 (Oct. 17, 2008), 94 SEC Docket 10887, 10891 & n.20 (citing cases).

commit future violations.[84] Trautman also affirmed his desire to continue working in the securities industry. These factors, coupled with his disciplinary history,[85] lead us to conclude that a bar from association with any broker or dealer is necessary to protect the public interest and will serve a remedial purpose.

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[84] At the hearing, Trautman testified that, although he did not have full-time employment, he was optimistic that he would find consulting work. On appeal, Trautman submitted sworn financial statements indicating that he has been providing consulting services. Moreover, in an affidavit filed with his reply brief and sworn to on May 21, 2008, Trautman attested that he "performed one consulting project this year for which [he] received about $20,000 in public securities."

[85] In 2002, Trautman executed a Letter of Acceptance, Waiver, and Consent ("AWC") with NASD, without admitting or denying the allegations, for carrying on a securities business through TWCO while failing to maintain minimum required net capital, in violation of Exchange Act Section 15(c), Exchange Act Rule 15c3-1, and NASD Conduct Rule 2110, and was jointly and severally fined $5,000. The Commission has "long recognized that [a respondent's] prior disciplinary history is to be considered in fashioning a sanction." *Consolidated Inv. Servs.*, 52 S.E.C. 582, 591 (1996). In reviewing that history, we have considered orders in both settled and litigated proceedings. *Russo Sec., Inc.*, 55 S.E.C. 58, 82 n.61 (2001); *see also, e.g., Pagel, Inc. v. SEC*, 803 F.2d 942, 948 (8th Cir. 1986) (holding that the Commission did not abuse its discretion in revoking broker-dealer's registration and barring it from association with any broker or dealer where, *inter alia*, broker-dealer previously had been sanctioned for other securities law violations pursuant to offer of settlement).

While the Division relies on two other previously-settled disciplinary matters, our review of the record indicates that it failed to introduce into evidence the related settlement documents. The only evidence regarding the prior disciplinary settlements is a Central Registration Depository Information report and an NASD complaint. We have held that an offer of settlement may not be considered for purposes of disciplinary history where "the plain language of the consent order unequivocally states that it may not be used in another proceeding." *See R. B. Webster Invs., Inc.*, 51 S.E.C. 1269, 1278 n.37 (1994); *Howard R. Perles*, 55 S.E.C. 686, 711-12 & n.41 (2002). In the absence of the actual settlement documents, we are unable to determine whether the plain language of the prior disciplinary settlements precludes their use in this proceeding. As a result, we have not considered those disciplinary matters against Trautman. In all events, we believe that the conduct evidenced here alone warrants the full sanctions imposed.

C. Cease-and-Desist Order

Securities Act Section 8A(a) and Exchange Act Section 21C authorize the Commission to impose a cease-and-desist order if it finds that any person has violated the federal securities laws or rules thereunder.[86] In determining whether a cease-and-desist order is appropriate, we look to whether there is some risk of future violations.[87] The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction.[88] A single violation can be sufficient to indicate some risk of future violations.[89] Our finding that a violation is egregious "raises an inference that it will be repeated."[90] We also consider whether other factors demonstrate a risk of future violations, including the seriousness of the violation, the isolated or recurrent nature of the violation, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, the respondent's state of mind, the sincerity of assurances against future violations, the recognition of the wrongfulness of the conduct, the opportunity to commit future violations, and the remedial function to be served by a cease-and-desist order in the context of any other sanctions sought in the proceeding.[91] This inquiry is flexible, and no single factor is dispositive.[92]

We find that the risk of future violations is high. Trautman's conduct was serious and recurrent. He engaged in deceptive conduct that spanned a substantial period of time. His violations were relatively recent and involved a high degree of scienter.[93] Trautman profited

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86 15 U.S.C. §§ 77A(a), 78u-3.

87 *KPMG Peat Marwick, LLP*, 54 S.E.C. 1135, 1185, *reconsideration denied*, 55 S.E.C. 1 (2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002).

88 *KPMG Peat Marwick*, 54 S.E.C. at 1191.

89 *See Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004).

90 *Id.*

91 *KPMG Peat Marwick*, 54 S.E.C. at 1192.

92 *Id.*

93 *See Rita J. McConville*, Exchange Act Rel. No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3152 (imposing cease-and-desist order based on "relatively recent" conduct that occurred more than five years prior to issuance of Commission's opinion), *petition denied*, 465 F.3d 780 (7th Cir. 2006), *cert. denied*, 128 S. Ct. 48 (2007); *Robert W. Armstrong, III*, Exchange Act Rel. No. 51920 (June 24, 2005), 85 SEC Docket 3011, 3040 (imposing cease-and-desist order based on conduct that occurred more than twelve years prior to issuance of Commission's

(continued...)

substantially from his deceptive conduct at the expense of mutual fund investors, who suffered significant losses because the late trading and deceptive market timing diluted the value of their shares. Although we have ordered that Trautman be barred from associating with any broker or dealer, the issuance of a cease-and-desist order will serve the remedial purpose of encouraging him to take his responsibilities more seriously in the future should he be allowed to re-enter the securities industry or should he act in a capacity that does not require registration. Therefore, in addition to a bar, it is in the public interest to impose a cease-and-desist order.

D. Disgorgement

Securities Act Section 8A(e), Exchange Act Section 21B(e), and Exchange Act Section 21C(e) authorize disgorgement, including reasonable prejudgment interest, in a cease-and-desist proceeding and a proceeding in which a civil money penalty may be imposed.[94] Disgorgement is an equitable remedy designed to deprive wrongdoers of their unjust enrichment and to deter others from similar misconduct.[95] "[T]he amount of disgorgement should include all gains flowing from the illegal activities."[96]

When calculating disgorgement, "separating legal from illegal profits exactly may at times be a near-impossible task."[97] As a result, disgorgement "need only be a reasonable approximation of profits causally connected to the violation."[98] Once the Division shows that its disgorgement figure is a reasonable approximation of the amount of unjust enrichment, the burden shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation.[99] Where disgorgement cannot be exact, the "well-established principle" is that the

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93 (...continued)
opinion; noting that, although the age of the violations militated against imposition of cease-and-desist order, "this consideration [was] outweighed by the other factors" discussed in the opinion).

94 15 U.S.C. §§ 77h-1(a), 78u-2(e), 78u-3(e).

95 *See Zacharias v. SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009) (citing *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989) and *SEC v. Bilzerian*, 29 F.3d 689, 697 (D.C. Cir. 1994), among other cases).

96 *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1114 (9th Cir. 2006) (quotations and citation omitted).

97 *First City Fin. Corp.*, 890 F.2d at 1231.

98 *Id.*

99 *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 2006); *First City Fin. Corp.*, 890 F.2d at 1232.

burden of uncertainty in calculating ill-gotten gains falls on the wrongdoer whose illegal conduct created that uncertainty.[100]

The Division requests that we order Trautman to disgorge his compensation from TWCO during the relevant period. Although counsel suggested at oral argument that Trautman's salary was $20,000 per month, Trautman submitted a "Schedule of Compensation" as an exhibit to his reply brief on appeal that indicates that, from 2001 to 2003, Trautman received $1,373,777.65 in total compensation from TWCO.[101] We find that ordering disgorgement will deprive Trautman of his unjust enrichment and deter others from similar misconduct, but we do not believe that all of his compensation is a reasonable measure of the amount of unjust enrichment causally connected to the violations.

Trautman participated in an illegal late trading and deceptive market timing scheme that substantially harmed mutual funds and their shareholders by causing approximately $102.7 million in dilution losses. The scheme enabled TWCO to generate approximately $22.6 million in mutual fund revenues. The $22.6 million constituted nearly seventy percent of TWCO's gross revenues of $32.5 million. After paying Wilson and Christian, TWCO retained forty percent of the $22.6 million, or around $9,040,000. A "majority" or "virtually all" of TWCO's mutual fund trades constituted late trades.

TWCO's CFO Barbera testified that the "vast majority" of the $9,040,000 was used to fund TWCO's operations and to pay firm expenses such as salaries, overhead, health benefits, and rent. Trautman testified similarly that TWCO's portion of the mutual fund revenues was used in the growth and development of the business and paid its operating expenses. Trautman also affirmed that TWCO had more money and resources as a result of the mutual fund revenues. In Trautman's words, "there was clearly a benefit for the firm that Christian and Wilson generated commissions."[102]

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[100] *Zacharias*, 569 F.3d at 472; *see also, e.g., SEC v. Calvo*, 378 F.3d 1211 (11th Cir. 2004) ("Exactitude is not a requirement; so long as the measure of disgorgement is reasonable, any risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty.").

[101] The Division relied on a substantially similar schedule, created by TWCO CFO Barbera and admitted into evidence, to contend that Trautman's total compensation during the relevant period was $1,373,799.95. The Division did not explain how it arrived at the $1,373,799.95. We have determined to use the total amount reflected by Trautman's schedule, $1,373,777.65, which is $22.10 less than the amount sought by the Division. We arrived at this figure by adding the W-2 and 1099 income listed on the schedule for the years 2001 through 2003. Trautman attested in his May 21, 2008 affidavit that this schedule was accurate as to him.

[102] We reject Trautman's argument that he received no personal financial benefit from the mutual fund trading. Disgorgement has been found to be appropriate where ill-gotten gains

(continued...)

TWCO's chairman Wasserman testified that the mutual fund revenues were "important" to TWCO's continued viability as a broker-dealer. The central importance of the mutual fund revenues to TWCO's operations was perhaps best illustrated by Trautman's conduct immediately following the firm's receipt of the subpoena from the NYAG. A "panicked" Trautman became "fearful" about the "massive amount of income" that potentially would be lost due to TWCO's inability to late trade, and suggested continuing some late trading for Ritchie Capital, which had the largest account, but concealing it from the regulators. Trautman indicated that he "couldn't run the firm" if, in the coming weeks, the income generated by Ritchie Capital's account was "going to disappear."

Trautman was a hands-on manager who left his "fingerprints" on all aspects of TWCO's operations, including its illegal late trading. During the scheme, the salary reported on his W-2 forms rose from $100,756.76 in 2001 to $240,000 in 2002 and $231,971.38 in 2003. Once the scheme ended, the salary reported on his W-2 forms declined to $39,426.53 in 2004 and $25,000 in 2005. Barbera testified that partners' salaries declined because TWCO "had substantial legal bills [incurred in connection with regulatory investigations] and of course lower revenues." It thus appears that the scheme enabled Trautman to continue drawing hundreds of thousands of dollars in salary and kept TWCO's business afloat.[103]

Under all the circumstances, we find that fifty percent of Trautman's 2001 compensation, fifty percent of his 2002 compensation, and fifty percent of nine months of his 2003 compensation (represented by three-fourths of that compensation), for a total of approximately $608,886, is a reasonable approximation of his unjust enrichment. The fifty percent measure reflects a ratio of approximately 50:50 between the illegitimate mutual fund revenues that TWCO retained, which were around $9,040,000 (representing TWCO's portion of the $22.6 million in mutual fund revenues after paying Wilson, Christian, and expenses) and the legitimate non-

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[102] (...continued)
have been used to sustain business operations. *Terence Michael Coxon*, 56 S.E.C. 934, 967 (2003), *aff'd*, 137 Fed. Appx. 975 (9th Cir. 2005).

[103] *See, e.g., SEC v. Conaway*, No. 2:05-CV-40263, 2009 WL 902063, at *20 (E.D. Mich. Mar. 31, 2009) (denying defendants' motions for summary judgment on disgorgement; stating that "[m]aintaining a fraudulent scheme so that one may continue to reap the benefit of a salary or other employment related benefits is enough to support a disgorgement order"); *SEC v. Church Extension of the Church of God, Inc.*, 429 F. Supp. 2d 1045, 1050 (S.D. Ind. 2005) (ordering defendants to disgorge one half of their base salaries for last full year of corporation's operations, plus interest, as proceeds from their securities law violations where the fraud enabled them to continue their employment); *cf. SEC v. First Pac. Bancorp.*, 142 F.3d 1186, 1192 (9th Cir. 1998) (affirming district court order holding defendant jointly and severally liability with corporate co-defendants for disgorgement where the fraud allowed defendant, as chairman, chief executive officer, and corporate counsel, to continue drawing hundreds of thousands of dollars in salaries, commissions, and consulting, management and legal fees).

mutual fund revenues, which were around $9.9 million (representing the difference between the $32.5 million in gross revenues and the $22.6 million in mutual fund revenues), and is intended to take into account certain mitigating factors, for instance, that Trautman provided some legitimate services to TWCO.[104] Accordingly, we order Trautman to disgorge $608,886, plus prejudgment interest calculated pursuant to Section 6621(a)(2) of the Internal Revenue Code,[105] and compounded quarterly.[106]

E. Civil Penalty

Exchange Act Section 21B authorizes the Commission to impose a civil money penalty where a respondent has willfully violated any provision of the federal securities laws and a penalty is in the public interest.[107] Exchange Act Section 21B establishes a three-tiered system of civil penalties, each with a larger maximum penalty amount applicable to increasingly serious misconduct.[108] The factors we consider in assessing the penalty required in the public interest are whether there was fraudulent misconduct, harm to others, or unjust enrichment, whether the respondent had prior violations, and the need for deterrence, as well as such other matters as justice may require.[109] The law judge imposed third-tier penalties of $500,000 on Trautman.

We find third-tier penalties appropriate in response to Trautman's misconduct. The Exchange Act provides that we may impose third-tier penalties where the misconduct "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement" and "directly or indirectly resulted in substantial losses or created a significant risk of substantial

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[104] *See Church Extension*, 429 F. Supp. 2d at 1050 (stating that order requiring defendants' disgorgement of one-half of base salaries was "intended to reflect in an equitable way the fact that both defendants also provided real and valuable services to [the corporation and subsidiary] for many years, as well as other mitigating factors").

[105] 26 U.S.C. § 6621(a)(2).

[106] Rule of Practice 600(b), 17 CFR § 201.600(b). "[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims." *Coxon*, 56 S.E.C. at 971.

[107] 15 U.S.C. § 78u-2.

[108] *Id.*

[109] *Id.*

losses to other persons or resulted in substantial pecuniary gain to the person who committed" the misconduct.[110]

The maximum third-tier penalty for misconduct by a natural person committed during the relevant period was $120,000 for each violation.[111] We have decided to impose civil penalties based on the totality of Trautman's fraudulent misconduct. Trautman engaged in the late trading of mutual fund shares. He also engaged in deceptive acts designed to facilitate the late trading. His late trading and other fraudulent activities directly or indirectly caused over $102 million in dilution losses to mutual fund shareholders and resulted in over $22 million in revenues to his firm. We consider a total penalty of $120,000, along with the other sanctions imposed, to be sufficient to deter future violations of the securities laws.

F. Trautman's Arguments Against Sanctions

Trautman argues that he is "destitute" and cannot pay disgorgement, interest, or civil penalties.[112] For the first time in these proceedings, he offers sworn financial statements purporting to document his financial situation.[113] Under Rule of Practice 630(a), we may, in our discretion, consider evidence of ability to pay in determining whether a respondent should be required to pay disgorgement, interest, or civil penalties.[114] Ability to pay, however, is only one factor that informs our determination and is not dispositive.[115] "Even when a respondent

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[110] *Id.*

[111] Violations committed by a natural person after February 2, 2001, but before February 14, 2005, have a maximum penalty per occurrence of $6,500 in the first tier; $60,000 in the second tier; and $120,000 in the third tier. *See* Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321-373 (1996) (codified at 28 U.S.C. § 2461 note); 17 C.F.R. § 201.1002.

[112] Trautman represents that he is a widower with three minor children, one of whom has significant medical issues.

[113] The law judge below rejected Trautman's asserted inability to pay because he failed to provide sworn financial statements to the Division before the hearing or to introduce a sworn financial statement as part of his direct case at the hearing. *Trautman Wasserman & Co.*, 92 SEC Docket at 1481.

[114] 17 C.F.R. § 201.630(a).

[115] *Id.*, Comment (a) (stating that, "[a]lthough no statutory requirement addresses inability to pay disgorgement or interest, the Commission considers evidence of inability to pay as a factor in determining whether a respondent should be required to pay disgorgement and

(continued...)

demonstrates an inability to pay, we have discretion not to waive the penalty, [disgorgement, or interest,] particularly when the misconduct is sufficiently egregious."[116]

We have reviewed the financial statements submitted by Trautman. Even accepting those statements at face value,[117] we find that the egregiousness of Trautman's conduct outweighs any

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115 (...continued)
interest as well as penalties"); *see, e.g.*, *Brian A. Schmidt*, 55 S.E.C. 576, 597-98 (2002) (noting that, under Exchange Act Section 21B, ability to pay a penalty is but one factor to consider in determining whether a penalty is in the public interest); *see also, e.g.*, *SEC v. Warren*, 534 F.3d 1368, 1370 (11th Cir. 2008) (per curiam) (stating that "at most" a defendant's ability to pay is one factor to be considered in imposing a civil money penalty or disgorgement for violations of the federal securities laws).

116 *Philip A. Lehman*, Exchange Act Rel. No. 54660 (Oct. 27, 2006), 89 SEC Docket 536, 543.

117 The financial information that Trautman submitted on appeal is vague, incomplete, and/or unsubstantiated in a number of respects. *See, e.g.*, *David Henry Disraeli*, Exchange Act Rel. No. 57027 (Dec. 21, 2007), 92 SEC Docket 852, 883 (finding that the "vague and unsubstantiated nature of [the respondent's] disclosures render them neither adequate nor credible as a basis for reducing the disgorgement or penalty amounts"), *aff'd*, 2009 WL 1791547 (D.C. Cir. June 19, 2009) (per curiam) (unpublished); *Lehman*, 89 SEC Docket at 549 (finding that respondent's claim of inability to pay "neither adequate nor credible because his assertions variously are vague, unsubstantiated, inconsistent, or contradicted by reliable evidence"). For example, Trautman submitted federal tax returns only for years 2001 through 2004, even though Section K.1 of the Commission's financial disclosure form requires the submission of federal tax returns from the year of the first violation alleged against the respondent to the present time. In the May 21, 2008 affidavit, Trautman stated that he "did not file 2005, 2006, or 2007 tax returns, but the IRS [Internal Revenue Service] has estimated [his] taxes due for 2005 and 2006 based on [his] 1099s and W2s." He did not provide any documentation showing estimated income for those years, nor did he indicate whether the IRS also estimated his taxes for 2007.

Trautman failed to attach "financial statements that [he] prepared for any purpose . . . in the year of the first violation alleged against [him] and all subsequent years," as required by Section K.3 of the Commission's financial disclosure form. In the May 21, 2008 affidavit, Trautman stated, "I have no copies of any prepared statement during the period. I did prepare one for the IRS but did not retain a copy."

Trautman claimed $10,000 per month in current income on his financial statements, but gave no details as to the source, which was described generally as "consulting

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discretionary waiver of disgorgement, prejudgment interest, and/or penalties.[118] Ordering Trautman to pay disgorgement of $608,886, plus prejudgment interest, and a single third-tier penalty of $120,000 is necessary to deter others from defrauding mutual funds and their shareholders through illegal and deceptive trading practices.

Trautman also argues that the sanctions imposed against him are inappropriate compared to the sanctions imposed on other respondents, citing specifically to the $250,000 that Christian paid in his settlement with the Commission.[119] It is well-established that the determination of appropriate remedial action depends on the facts and circumstances of each case and cannot be determined by comparison with the actions taken in other proceedings.[120] "Moreover, parties that settle disciplinary proceedings often receive less severe sanctions than those who do

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[117] (...continued)
fees." In the May 21, 2008, affidavit, Trautman stated, "I performed one consulting project this year, for which I received about $20,000 in public securities." No further information was supplied.

At the hearing, Trautman claimed that there were approximately ten or eleven private equity companies in which TWCO had invested that potentially could provide him with "some level of capital gain or income" in the future. Trautman represented that one (unidentified) private equity company "went public and I got 30 grand. So that could happen again. I'm cautiously hopeful that it will." However, he did not indicate when this occurred. While Trautman testified that he believed he gave the Division an "itemized list" of those private equity companies, our review of the record did not reveal any list.

[118] *See, e.g., Disraeli*, 92 SEC Docket at 883 (finding that respondent's misconduct was sufficiently egregious and outweighed any financial information submitted in support of his asserted inability to pay the disgorgement and penalty amounts) & n.125 (collecting cases); *see also, e.g., Warren*, 534 F.3d at 1370 (finding that nothing in the securities laws or decisional law prohibits a district court from imposing a penalty or disgorgement in excess of a securities law violator's ability to pay; holding that district court acted within its discretion in ordering the defendant to pay disgorgement, interest, and a penalty, even assuming an inability to pay, where such inability to pay did not merit significant weight in comparison to the other equities).

[119] *See supra* n. 17.

[120] *See Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) (stating that "[t]he employment of a sanction within the authority of an administrative agency is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases"); *Geiger*, 363 F.3d at 488 (stating that "[t]he Commission is not obligated to make its sanctions uniform, so we will not compare this sanction to those imposed in previous cases").

not."[121] Accordingly, we reject Trautman's argument that we should reduce his sanctions based on those imposed in settlements with other individuals who engage in deceptive trading practices.

An appropriate order will issue.[122]

By the Commission (Chairman SCHAPIRO and Commissioners CASEY, WALTER, AGUILAR and PARADES).

Elizabeth M. Murphy
Secretary

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121 *Ficken*, 94 SEC Docket at 10893 & n.31 (citing cases).

122 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 9088 / December 15, 2009

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61167 / December 15, 2009

Admin. Proc. File No. 3-12559

In the Matter of

GREGORY O. TRAUTMAN

c/o Leon Baer Borstein
Borstein & Sheinbaum
420 Lexington Avenue, Suite 2920
New York, New York 10170

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Gregory O. Trautman be, and he hereby is, barred from association with any broker or dealer; and it is further

ORDERED that Gregory O. Trautman cease and desist from committing or causing any violations or future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 15(c) of the Exchange Act of 1934, and Exchange Act Rules 10b-3 and 10b-5; and it is further

ORDERED that Gregory O. Trautman disgorge $608,886, plus prejudgment interest of $260,645.29, such prejudgment interested calculated beginning from October 1, 2003, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Gregory O. Trautman pay a civil money penalty in the amount of $120,000.

Payment of the amount to be disgorged and the civil money penalty shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, Operations

Center, 6432 General Green Way, Alexandria, VA 22312; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding. A copy of the cover letter and check shall be sent to Paul G. Gizzi, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, 4th Floor, New York, NY 10281.

By the Commission.

Elizabeth M. Murphy
Secretary