UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4417 / June 9, 2016

Admin. Proc. File No. 3-15263

In the Matter of

ZPR INVESTMENT MANAGEMENT, INC.,
and MAX E. ZAVANELLI

ORDER DENYING MOTION FOR RECONSIDERATION

On October 30, 2015, we found ZPR Investment Management, Inc. ("ZPRIM"), and its former president and owner, Max E. Zavanelli ("Zavanelli"), liable for, among other things, ZPRIM's false or misleading claims of compliance with the Global Investment Performance Standards ("GIPS") in magazine advertisements and newsletters that failed to provide returns information required by the GIPS Advertising Guidelines.[1] Respondents seek reconsideration of our findings that the misrepresentations in these documents were material, that they acted with scienter, and that Zavanelli should be barred from the securities industry.[2] They assert that the First Circuit's decision in *Flannery v. SEC*, decided after our opinion, supports these arguments.[3] We deny Respondents' motion because they revisit arguments that we already rejected in our opinion. We also explain why *Flannery* does not require a different result.

I. Background

In our October 30, 2015 opinion, we found that ZPRIM falsely or misleadingly claimed compliance with GIPS in magazine advertisements and newsletters that failed to provide the

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1 *ZPR Inv. Mgmt., Inc.*, Investment Advisers Act Release No. 4249 (Oct. 30, 2015), https://www.sec.gov/litigation/opinions/2015/ia-4249.pdf ("Slip Op.") at 3 (explaining that ZPRIM "violated Advisers Act Sections 206(1), (2), and (4), and Advisers Act Rule 206(4)-1(a)(5) through its false or misleading claims of GIPS compliance in the magazine articles and newsletters," that Zavanelli aided, abetted, and caused these violations, and that Zavanelli directly violated Sections 206(1) and (2) with respect to them).

2 We also censured ZPRIM, imposed cease-and-desist orders, and ordered ZPRIM and Zavanelli to pay, respectively, $250,000 and $570,000 civil money penalties.

3 810 F.3d 1 (1st Cir. 2015), *vacating John P. Flannery*, Exchange Act Release No. 73840, 2014 WL 7145625 (Dec. 15, 2014) (Opinion of the Commission).

returns information required by the GIPS Advertising Guidelines.[4] The GIPS are "universal, voluntary standards to be used by investment managers for quantifying and presenting investment performance that ensure fair representation, full disclosure, and apples-to-apples comparisons."[5] Under GIPS, if a firm chooses to advertise that it is GIPS-compliant and includes performance data in the advertisement, it must disclose specified returns in its advertisements.[6] The version of the GIPS in place during the relevant period required such firms to provide "(1) period-to-date composite performance results and (2) either one-, three-, and five-year cumulative annualized composite returns or five years of annual composite returns."[7]

We found that, although ZPRIM claimed compliance with GIPS in magazine advertisements and newsletters that included performance information, its claims were false or misleading because ZPRIM did not include the returns that the GIPS Advertising Guidelines required to be disclosed in those advertisements:[8]

1. In late 2008 advertisements, ZPRIM disclosed only five, ten, and 20-year cumulative and ten-year annualized returns, which all exceeded its benchmark, rather than the year-to-date and one, three, and five-year annualized returns (or five years of annual returns) required by the Guidelines.[9] The returns ZPRIM disclosed ranged from 14.21% (10-year annualized) to 1187.05% (20-year compounded).[10] If ZPRIM had followed the Guidelines, it would have shown negative period-to-date returns (from -17.02% to -18.42%) that underperformed its benchmark.[11]

2. In 2011 advertisements, ZPRIM touted "28 Years of Portfolio Management by MAX ZAVANELLI" and proclaimed that it was "THE #1 MANAGER" or "TRIPLE #1" "FOR THE 3rd TIME." But ZPRIM disclosed only returns over periods that showed ZPR beating all other "TOP 10 MANAGERS," and failed to include other data required by the Guidelines.[12]

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4 Slip Op. at 15-31. We also found that ZPRIM made misrepresentations in two Morningstar reports because it falsely claimed that an independent GIPS verifier had verified its results "to the present," after that verifier had resigned, and because ZPRIM had denied the existence of a Commission investigation of which it had been notified. *Id.* at 31-35.

5 *Id.* at 4 (citation omitted).

6 *Id.*

7 *Id.* at 6.

8 *Id.* at 15-18, 25-29.

9 *Id.* at 6-7, 15.

10 *Id.* at 7.

11 *Id.* at 6-7.

12 *Id.* at 12-13, 15-16.

3. In 2009 newsletters distributed to clients and prospective clients, ZPRIM also cherry picked favorable data, or included data intended to support a point regarding the performance of its composites, without including the information required by the Guidelines.[13]

ZPRIM never disclosed that it had failed to follow the GIPS Advertising Guidelines and that its claims of compliance with them were false.[14]

Applying the well-established materiality standard,[15] we found that Respondents' undisclosed failure to comply with the GIPS Advertising Guidelines was material for two reasons.[16] First, compliance with the Guidelines performs an important independent role: it "ensures that, where a firm claims compliance and discloses financial results, those results are complete, fairly presented, and comparable to those of other firms."[17] By including a claim of GIPS compliance in an advertisement, a firm represents that the results it discloses are consistent with the Advertising Guidelines and benefits from this claim. Indeed, Zavanelli agreed that it was "very important" for marketing to institutional clients to claim GIPS compliance, and he testified that he wanted to be "measured on a GIPS basis" so that ZPRIM could have "bragging rights" based on its performance.[18] Yet, in its violative advertisements, ZPRIM claimed these bragging rights without complying with the Advertising Guidelines. We found this material because "[i]n deciding whether to entrust their money to ZPRIM, potential clients would have considered it significant that ZPRIM had not complied with the Advertising Guidelines (as it had represented) and had not disclosed a track record of performance comparable to a firm that had done so."[19]

Second, we found that "ZPRIM's false claim of compliance with GIPS in its 2008 magazine advertisements is also material because if ZPRIM had complied with the Advertising Guidelines, it would have disclosed that its SCV composite was losing money and significantly

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13 *Id.* at 9, 27, 28.

14 *Id.* at 17-18.

15 "An omitted fact is material 'if there is a substantial likelihood that a reasonable [investor] would consider it important' in making an investment decision." Slip Op. at 18 (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988)). "[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic*, 485 U.S. at 231-32 (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U. S. 438, 449 (1976)).

16 Slip Op. at 18-19; *see also id.* at 21 (additional discussion with respect to 2011 advertisements); *id.* at 29-30 (discussion of materiality with respect to 2009 newsletters).

17 *Id.* at 18-19 & nn. 59 & 60.

18 *Id.* at 5.

19 *Id.* at 19.

underperforming its benchmark, the Russell 2000."[20] "A reasonable investor would have considered the omitted performance information significant to its investment decision."[21]

We also considered Respondents' argument that ZPRIM's false or misleading claims of GIPS compliance were immaterial because ZPRIM purportedly disclosed the returns information that it omitted from its advertisements by other means, *i.e.*, its website and information sent to potential clients who inquired about its services. We rejected this argument for three reasons.

First, by claiming GIPS compliance in its advertisements, ZPRIM represented that they included all the performance information required by GIPS. We concluded that "[i]nvestors should not be required to search for additional information that a firm represents it has already provided through its claims of GIPS compliance."[22]

Second, we rejected an underlying assumption of Respondents' argument: that by providing or making available by other means the returns data it omitted from its advertisements ZPRIM introduced "corrective disclosures" into the total mix of information that cured its false or misleading claims of GIPS compliance.[23] Instead, we found that ZPRIM "did not correct" those claims because it never publicly acknowledged that they "were false, distributed corrected advertisements addressing [them], or even directed recipients of its advertisement to the information required by the Guidelines that it omitted from the advertisements."[24] Providing the data omitted from the advertisements through other means could not cure ZPRIM's false or misleading claims of GIPS compliance because it did not speak to that compliance.

Third, we explained that "[e]ven if we were inclined to consider information outside the advertisements and found that the exact information omitted from the advertisements was available online or otherwise, we do not believe that ZPRIM adequately drew attention to it here."[25]

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20 *Id.*

21 *Id.*

22 *Id.*; *see also id.* at 18 n.59 (citing authority in which we declined to consider other information in the total mix).

23 Although we reached this conclusion in a portion of our opinion that explained why ZPRIM's advertisements were false, our analysis is also relevant to ZPRIM's materiality argument.

24 *Id.* at 17-18. We also explained that although ZPRIM specifically corrected another element of its December 2008 advertisement, it never sought to fix the misrepresentation regarding GIPS compliance. *Id.* at 18 n.54.

25 *Id.* at 20.

On November 16, 2015, Respondents moved for reconsideration of our opinion;[26] they filed a supplemental brief arguing that *Flannery* supported reconsideration on January 6, 2016.[27]

II. Analysis

Reconsideration is an "extraordinary" remedy[28] "designed to correct manifest errors of law or fact or permit the presentation of newly discovered evidence."[29] A party "may not use a motion for reconsideration to reiterate arguments previously made or to cite authority previously available."[30] Reconsideration motions are thus granted only in exceptional cases.[31]

Respondents fail to meet this standard because they raise three principal arguments that we already addressed and rejected in our opinion. They argue that (1) their misrepresentations regarding GIPS compliance were not material given that the total mix of information available to investors purportedly contained the information they omitted from their advertisements; (2) the evidence did not support our findings that they acted with scienter; and (3) imposing an industry bar against Zavanelli was not in the public interest. We addressed each of these arguments at length in our opinion and found them to be without merit.[32]

The First Circuit decided *Flannery* after we issued our opinion in this case. Respondents contend that *Flannery* reinforces the arguments that they made based on the disclosure of information outside their advertisements. According to Respondents, *Flannery* strengthens their argument that ZPRIM's false claims of GIPS compliance were not material because, by

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26 *See ZPR Inv. Mgmt., Inc.*, Advisers Act Release No. 4260, 2015 WL 6777087, at *1 (Nov. 6, 2015) (extending deadline for filing reconsideration motion until November 16, 2015).

27 *Flannery* was decided after Respondents filed their reconsideration motion. The Commission granted their request to submit supplemental briefing with respect to it and ordered the Division of Enforcement to file a responsive brief. *See ZPR Inv. Mgmt., Inc.*, Advisers Act Release No. 4294, 2015 WL 9256653, at *1 (Dec. 18, 2015).

28 *Johnny Clifton*, Exchange Act Release No. 70639, 2013 WL 5553865, at *1 (Oct. 9, 2013).

29 *Daniel Imperato*, Exchange Act Release No. 74886, 2015 WL 2088435, at *1 (May 6, 2015) (quoting *Steven Altman, Esq.*, Exchange Act Release No. 63665, 2011 WL 52087, at *1 (Jan. 6, 2011)). We will accept only such additional evidence that "the movant could not have known about or adduced before entry of the order subject to the motion for reconsideration." *Eric J. Brown*, Exchange Act Release No. 66752, 2012 WL 1143573, at *1 (Apr. 5, 2012) (quoting *Perpetual Sec., Inc.*, Exchange Act Release No. 56962, 2007 WL 4372765, at *1 (Dec. 13, 2007)).

30 *Imperato*, 2015 WL 2088435, at *1 (quoting *Altman*, 2011 WL 52087, at *1).

31 *Brown*, 2012 WL 1143573, at *1 (citing *Feeley & Willcox Asset Management Corp.*, Exchange Act Release No. 48607, 2003 WL 22316308, at *1 (Oct. 9, 2003)).

32 *See, e.g.*, Slip Op. at 18-21, 29-30, 32-33 (materiality); *id.* at 22-26, 30-31, 34-35 (scienter); *id.* at 37-43 (industry bar on Zavanelli).

providing additional data to potential investors and on its website, ZPRIM otherwise provided or made available the returns data that the GIPS Advertising Guidelines required it to include in its advertisements. Because *Flannery* had not been decided when we issued our opinion, we write to clarify that it provides no basis for reconsideration.

A. *Flannery* has no bearing on liability under the Advisers Act.

In *Flannery*, the Commission found that a respondent had made a material misrepresentation with scienter in a slide presentation that asserted that a fund typically was 55% invested in asset-backed securities ("ABS"), although its actual exposure to ABS at the time was around 100% of its portfolio and had exceeded 55% for several quarters.[33] The First Circuit, however, concluded that the record supported only a "thin" showing of materiality with respect to this "typical portfolio slide" based on a number of considerations, including that information about the "actual percent[age] of sector investment" for the fund that showed it was 100% invested in ABS had been made available to clients six weeks before the presentation was made.[34] The Court concluded that this "marginal" materiality showing,[35] when considered in light of other evidence in the record,[36] could not support a showing of recklessness sufficient to establish scienter, and it vacated our order finding the respondent liable and imposing sanctions.[37]

Respondents argue that finding the information they omitted from their advertisements to be material despite the availability of that information from other sources is "contrary to *Flannery*." But *Flannery* emphasized that it "d[id] not suggest that the mere availability of accurate information negates an inaccurate statement"; rather, the Court limited its holding to the

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33 *Flannery*, 2014 WL 7145625, at *19-24.

34 810 F.3d at 11. The Court also found that additional facts weighed against a finding of materiality: the specific purpose of the meeting at which the slide was presented, that the slide at issue was but one of 20 slides in the presentation, that it was not mentioned in a contemporaneous report prepared by a consultant who attended the meeting, and certain expert testimony. *Id*.

35 *Id*. at 4, 9-10.

36 The Court recited that the respondent testified that "in his experience investors did not focus on sector breakdown when making their investment decisions and that [fund] investors did not focus on how much of [its] investment was in ABS versus [mortgage-backed securities]," he "did not recall ever discussing the Typical Portfolio Slide or being asked a question about the actual sector breakdown when presenting the slide," and "[h]e did not update the Typical Portfolio Slide's sector breakdowns because he did not think the typical sector breakdowns were important to investors." 810 F.3d at 11-12. The Court also observed that "[t]o the extent that an investor would want to know the actual sector breakdowns, [the respondent] would bring notes with 'the accurate information' so that he could answer any questions that arose." *Id*. at 12.

37 *Id*. at 4, 12, 14. The Court also vacated our findings of liability and sanctions issued against the other respondent in the case.

narrow circumstances of the case.[38] *Flannery* has no bearing on our conclusion that Respondents' misrepresentations were material for a fundamental reason: unlike in *Flannery*, Respondents in this case made material misrepresentations in advertisements disseminated to the general public, and the Advisers Act and rules thereunder prohibit such misrepresentations in advertisements to clients or prospective clients.

Advisers Act Section 206(1) prohibits investment advisers from "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud any client or prospective client."[39] Section 206(2) includes a "broad proscription against 'any . . . practice . . . which operates . . . as a fraud or deceit upon any client or prospective client.'"[40] And Section 206(4) simply prohibits "any act, practice, or course of business which is fraudulent, deceptive, or manipulative,"[41] and in conjunction with Rule 206(4)-1(a)(5), bars registered investment advisers from publishing, circulating, or distributing "any advertisement . . . [w]hich contains any untrue statement of a material fact, or which is otherwise false or misleading."[42]

We have recognized previously that Sections 206(1), (2), and (4) and Rule 206(4)-1(a)(5) together "prohibit investment advisers from misstating material facts or omitting facts necessary to make a prior statement non-misleading in promotional literature and other communications to clients or prospective clients."[43] Indeed, we adopted Rule 206(4)-1(a)(5) to "foreclose[e] the use of advertisements which have a tendency to mislead or deceive clients or prospective clients."[44] That is exactly the type of advertisement that Respondents employed here.

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[38] *Id.* at 11 n.8. Even under these narrow circumstances, the Court referred to the availability of the information as relevant, not dispositive. *Id.* As explained below in Section II.B, *Flannery* is distinguishable based on its facts.

[39] 15 U.S.C. § 80b-6(1).

[40] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963) (citing Advisers Act Section 206(2), 15 U.S.C. § 80b-6(2)).

[41] 15 U.S.C. § 80b-6(4).

[42] 17 C.F.R. § 275.206(4)-1(a)(5).

[43] *Anthony Fields*, Advisers Act Release No. 4028, 2015 WL 728005, at *14 (Feb. 20, 2015); *see also Marketlines v. SEC*, 384 F.2d 264, 266 (2d Cir. 1967) (affirming Commission order finding that respondent "violated the antifraud provisions of Section 206 of the [Advisers] Act by publishing misleading advertisements"); *Stanford Inv. Mgmt, Inc.*, Advisers Act Release No. 228, 43 SEC 864, 1968 WL 86065, at *2 (Aug. 30, 1968) (explaining that "[w]e have previously taken action with respect to improper advertising practices of a number of investment advisers" and "again emphasiz[ing] the importance of adherence to the required standards under the securities acts with respect to advertising").

[44] *Advertisements by Investment Advisers*, Advisers Act Release No. 121 (Nov. 1, 1961), 26 Fed. Reg. 10,548, 10,549 (Nov. 9, 1961).

Respondents' false claims of GIPS compliance are squarely within the prohibitions of Section 206 and Rule 206(4)-1(a)(5).[45] By claiming GIPS compliance, Respondents misrepresented to prospective clients that ZPRIM complied with the GIPS Advertising Guidelines. As we stated in our opinion, in "deciding whether to entrust their money to ZPRIM, potential clients would have considered it significant that ZPRIM had not complied with the Advertising Guidelines (as it had represented) and had not disclosed a track record of performance comparable to a firm that had done so."[46] Zavanelli conceded that GIPS compliance was "very important" for marketing to institutional clients, and he wanted ZPRIM to be "measured on a GIPS basis" so that it could claim "bragging rights" based on its performance.[47] Nonetheless, ZPRIM never publicly acknowledged that its claims of GIPS compliance in its advertisements were false or otherwise corrected them.[48] Because Respondents employed materially misleading misrepresentations about a core fact—compliance with GIPS—in their advertisements, they employed a device or artifice to defraud prospective clients and engaged in a practice that operated as a fraud on prospective clients. Respondents also engaged in a fraudulent act by publishing, circulating, and distributing advertisements containing material misstatements.

1. The information Respondents may have provided in subsequent disclosures does not render the misstatements in the advertisements immaterial.

Respondents argue that their misrepresentations were immaterial because they provided the information they omitted from their advertisements "in subsequent disclosures" that they sent to prospective clients who read those advertisements and contacted ZPRIM. Subsequent disclosures cannot render a misstatement in an advertisement immaterial to prospective clients. Prospective clients who do not respond to the advertisement or otherwise seek more information are left with only the false advertisement. Providing additional information only to prospective clients who respond to a false advertisement cannot render the initial misrepresentation in the

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45 Although Rule 206(4)-1(a)(5) applies to registered investment advisers only, we found that Zavanelli aided, abetted, and caused ZPRIM's violations of the rule with respect to the magazine advertisements and newsletters. Slip Op. at 36-37.

46 *Cf. Riggs Inv. Mgmt. Corp. v. Columbia Partners, LLC,* 966 F. Supp. 1250, 1262, 1268 (D.D.C. 1997) (recognizing that "[c]ompliance with AIMR," the predecessor of GIPS, "has importance for a firm's reputation," and concluding that "to advertise oneself as meeting such an important industry standard while knowingly being out of compliance is false advertising").

47 *See supra* note 18 and accompanying text.

48 *See supra* notes 23 and 24 and accompanying text.

advertisement itself immaterial. And we have never held that, for purposes of Section 206,[49] only the persons who respond to a misleading advertisement are prospective clients.[50]

We also believe that the subsequent disclosures provided to prospective clients who responded to the advertisement did not render the misstatements therein immaterial as to those prospective clients. When a prospective client decides whether to respond to an advertisement, he cannot consider information he does not have, and that an adviser provides only after contact. When a prospective client responds to a materially false advertisement, it is reasonable to believe that the prospective client has been influenced by the misrepresentation in the advertisement. The adviser's false statement has succeeded because it has garnered interest, regardless of whether the adviser later provides enough information for an astute individual to detect its misstatement.

Accordingly, we think it appropriate to look to the content of the advertisement in determining materiality and to exclude subsequent communications delivered only to those individuals who respond. Respondents attempted to attract or retain clients through false advertising; they cannot avoid liability on the basis that they later provided only to the very customers who they attracted through their misstatements the information that they failed to disclose in their advertisements. We therefore reject Respondents' argument that the misrepresentations in the advertisements were immaterial, even accepting their premise that,

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49 Advisers Act Sections 206(1) and (2) prohibit certain conduct by investment advisers with respect to "any client or prospective client." *See* 15 U.S.C. § 80b-6(1) (prohibiting "employ[ing] any device, scheme, or artifice to defraud any client or prospective client"); 15 U.S.C. § 80b-6(2) (prohibiting "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client"); *cf.* 15 U.S.C. § 80b-6(4) (prohibiting "any act, practice, or course of business which is fraudulent, deceptive, or manipulative" without requiring nexus to "any client or prospective client"); 17 C.F.R. § 275.206(4)-1(a)(5) (prohibiting investment advisers from "publish[ing], circulat[ing], or distribut[ing]" certain advertisements without reference to clients or prospective clients).

50 *See Fields*, 2015 WL 728005, at *15 (finding that "[v]ia AFA's Form ADV and AFA's and Platinum's websites, Fields disseminated false and material information to prospective clients"); *Sol Jay Rifkin*, Advisers Act Release No. 417, 1974 WL 162954, at *1 (June 6, 1974) (settled case) (finding that material misrepresentations in newspaper and periodical advertisements violated Sections 206(1), (2), and (4) and Rule 206(4)-1 by deceiving prospective clients); *see also SEC v. Bolla*, 401 F. Supp. 2d 43, 68 (D.D.C. 2005) (noting that "Section 206(1) and (2) both cover 'any client or prospective client'" and rejecting attempt to "improperly limit[]" set of actions to those involving certain clients "when all WIN clients or potential clients are the relevant subset"), *aff'd sub nom. in relevant part*, *SEC v. Washington Inv. Network*, 475 F.3d 392 (D.C. Cir. 2007) (remanding for modification of injunctive relief).

"each and every prospective client of ZPRIM was given full and fair disclosure of all required performance results of the firm before they decided to select ZPRIM as their adviser."[51]

Respondents' argument also fails for an additional reason: their assertion that all relevant information was provided "immediately" to clients who responded has scant support in the record. Our opinion recognized that prospective clients did not receive a GIPS-compliant presentation until they received contracts to retain ZPRIM and that it "would have been important to potential investors to receive the information at issue to be able to compare performance numbers before they reached this advanced stage."[52] Respondents assert that ZPRIM sent out a package containing the missing performance returns to prospective clients who contacted its marketing agent for more information, well before sending them a contract with the formal GIPS-compliant presentation we referenced in our opinion. The record does not substantiate these assertions.

Respondents rely on a single email dated August 12, 2008, that ZPRIM sent an individual who contacted its marketing agent. The email predates the advertisements at issue, and the person who sent it did not testify at the hearing. ZPRIM's marketing agent testified that he believed ZPRIM sent out various materials but he did not describe them with specificity, and he initially testified that he did not know what ZPRIM sent prospective clients. And for his part, Zavanelli testified that ZPRIM sent out "many different packages" and agreed that "the materials that were sent changed over time" and that he did not know what materials were actually sent to potential clients because he was not copied on each mailing. ZPRIM also changed its advertisements over time to remove information required by the GIPS Advertising Guidelines. We cannot infer from one email that ZPRIM consistently provided all information that it omitted from its advertisements.

Respondents believe that so long as a prospective client eventually gets all relevant information before making an ultimate investment decision there can be no material misrepresentation and no violation. While this might defeat reliance or harm in a private securities fraud action, it is not a bar to liability in a Commission enforcement proceeding under the Advisers Act.[53] Liability under Advisers Act Section 206 does not require that the fraudulent conduct occur in connection with the offer, purchase, or sale of securities.[54] To the contrary,

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[51] Respondents do not explain, or cite to anything in the record to demonstrate, how they can be sure that no prospective clients decided to select ZPRIM on the basis of its false advertisements.

[52] Slip Op. at 20.

[53] *See generally* Slip Op. at 21 & n.69 ("[T]he Division is not required to establish investor reliance or loss to prevail on its claims.").

[54] *SEC v. Lauer*, No. 03-80612-CIV, 2008 WL 4372896, at *24 (S.D. Fla. Sept. 24, 2008), *aff'd*, 478 F. App'x 550 (11th Cir. 2012); *see also* Applicability of the Investment Advisers Act, Advisers Act Release No. 1092, 1987 WL 112702, at *9 (Oct. 8, 1987) (staff interpretive release stating that the Section 206 provisions "do not refer to dealings in securities but are stated in terms of the effect or potential effect of prohibited conduct on the client").

Section 206 includes within its scope misrepresentations that are not specific to a client investment decision.[55]

2. The information Respondents may have provided on their website does not render the misstatements in their advertisements immaterial.

Respondents also argue that their misrepresentations were immaterial because the advertisements "disclosed the firm's website which . . . contained all of the information required by the" Advertising Guidelines. In our opinion, we noted that "ZPRIM did not mention that its website contained financial information that it had omitted from its magazine advertisements."[56] And, as discussed below, the mere availability of accurate information is insufficient to render false information that an investment adviser provides to clients or potential clients immaterial.

"Investment advisers are fiduciaries whose actions must be governed by the highest standards of conduct."[57] Respondents present a materiality argument that is inimical to their fiduciary obligations. They assert that an investment adviser may solicit clients on the basis of false or misleading representations so long as the adviser makes available information sufficient for a prospective client to detect the adviser's misrepresentation elsewhere. We disagree.

On this point, the opinion in *SEC v. Bolla* is instructive.[58] That case involved an investment adviser firm (WIN) with two principals (Bolla and Radano). After Bolla was barred from association with any investment adviser, Radano and WIN failed to disclose the bar to clients or made misleading statements regarding Bolla's status. Radano argued that these statements and omissions were not material because when he spoke with one client, she was

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55 *See, e.g.*, *SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1106 (9th Cir. 1977) (investment adviser violated Section 206 by making misrepresentations in a book and newsletter concerning its investment strategy and the results of a model portfolio); *see also* Applicability of the Investment Advisers Act, 1987 WL 112702, at *9 (staff interpretive release stating that "the Commission has applied Sections 206(1) and (2) in circumstances in which the fraudulent conduct arose out of the investment advisory relationship between an investment adviser and its clients, even though the conduct does not involve a securities transaction").

56 Slip Op. at 20.

57 *Valicenti Advisory Servs., Inc.*, Advisers Act Release No. 1774, 1998 WL 798699, at *6 (Nov. 18, 1998), *petition denied*, 198 F.3d 62 (2d Cir. 1999) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. at 191-92; *Rosenfeld v. Black*, 445 F.2d 1337, 1342-44 (2d Cir. 1971)). Investment advisers are charged with the affirmative duty of "utmost good faith, and full and fair disclosure of all material facts" and the obligation "to employ reasonable care to avoid misleading" their clients through half-truths or incompletely volunteered information. *SEC v. Capital Gains*, 375 U.S. at 191, 194; *accord Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *7 & n.44 (Sept. 26, 2007), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008).

58 401 F. Supp. 2d 43.

already aware of the bar. The court rejected this argument because the standards applicable to investment advisers require more than just the availability of the truth through other means:

> Given the fiduciary duties owed by an investment adviser to his clients and the necessary foundation of truth and ethical action underlying the relationship, to take up Defendants' suggestion and allow an investment adviser to freely lie or omit information to his clients—as long as they know that he cannot be trusted—is to court the absurd and undermine the basis of Section 206.[59]

Unlike in *Bolla*, Respondents do not assert that the readers of their advertisements were already aware that ZPRIM's claims of GIPS compliance were false or misleading when they read them. Rather, Respondents argue that their advertisements disclosed the firm's website and the website contained the omitted information represented to be in their advertisements. The same rationale that caused the court to reject the materiality argument in *Bolla* supports rejecting Respondents' argument here: the fiduciary duty owed by an investment adviser does not countenance the adviser making a misrepresentation in an advertisement to attract clients even where the prospective client might be able to discern that the statement was false through information available elsewhere.

Moreover, Respondents' argument is weaker than the argument the court rejected in *Bolla*. In *Bolla*, the defendants relied on a client's actual knowledge of a bar, but here Respondents point to disclosures on its website that merely could have alerted potential clients to the truth. As we said in our opinion, "ZPRIM did not sufficiently bring to investors' attention the information it contends cures its misrepresentations."[60] Rather, "ZPRIM generically referenced its website in its advertisements but did not specify what information was available on the website or otherwise direct investors to it for specific information."[61] "Put another way, the law does not put the onus on investors to seek out disclosures; it puts the obligation to provide disclosures on people who solicit and manage investors' money."[62]

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[59] *Id.* at 69; *see also Washington Inv. Network*, 475 F.3d at 404 (agreeing "that WIN's evasiveness in these conversations constituted fraudulent behavior in violation of Section 206").

[60] Slip. Op. at 20 & n.68; *see also SEC v. Morgan Keegan & Co., Inc.*, 678 F.3d 1233, 1254 (11th Cir. 2012) (finding that website disclosures to which defendant did not specifically direct customers did not alter total mix of information so as to render contrary oral misrepresentations immaterial); *SEC v. Washington Inv. Network*, 475 F.3d at 405 (rejecting defendants' argument that public availability of undisclosed bar order rendered statements immaterial because "[t]he existence of the bar order may have been public information, but it was not information that was so widely disseminated that an average small investor could be expected to be aware of it").

[61] Slip Op. at 20 n.66. Respondents' advertisements referenced its top level web page, zprim.com. The webpages that Respondents contend provided the omitted information are from other web addresses under that top level page. In addition, those webpages were not printed on dates around the times of the misrepresentations at issue.

[62] *SEC v. Nutmeg Grp., LLC*, No. 09–cv–1775, __ F. Supp. 3d __, ___, 2016 WL 690930, at *16 (N.D. Ill. Feb. 18, 2016).

B. *Flannery* is distinguishable on its facts.

In addition to having no bearing on liability under the Advisers Act, *Flannery* is distinguishable on its facts. We reject Respondents' assertion that they are in "the exact situation addressed by *Flannery*." *Flannery* addressed a slide that disclosed "typical" holdings. The court concluded that "when a slide is labeled '*typical*,' and where a reasonable investor would not rely on one slide but instead would conduct due diligence when making an investment decision, the availability of actual and accurate information is relevant."[63] Here, ZPRIM's misrepresentations in its advertisements concerned the *actual* performance returns. By claiming compliance with GIPS, ZPRIM represented that it had provided in its advertisements all the actual performance information required by the Guidelines, although it had not. Investors "should not be required to search for additional information that a firm represents it has *already provided* through its claims of GIPS compliance."[64]

We also reject Respondents' assertion that *Flannery* supports finding their misrepresentations to be immaterial in light of "the absence of any existing or prospective ZPRIM clients called by the Division to testify" about materiality. Although the *Flannery* court found that the absence of investor testimony supported its conclusions regarding the materiality (or lack thereof) of the representations, *Flannery* did not establish a requirement that investor testimony must be used to establish materiality.[65] Rather, it concluded that the evidence as a whole indicated that there were either no material misrepresentations or that the evidence of materiality was thin. Here, testimony established that "ZPRIM decided to become GIPS-compliant so it could compete for institutional clients," that "many institutional investors will not consider investment advisers unless they provide GIPS-compliant returns," and that Zavanelli himself agreed that GIPS compliance was "very important" for marketing to institutional clients.[66] Indeed, before ZPRIM finalized its late 2008 advertisements, Zavanelli "specifically instructed" that the advertisements "retain the footnote claiming GIPS compliance."[67] Investors did not need to testify as to the misrepresentations' materiality in light of this other evidence.

Finally, we reject Respondents' assertion that "the *Flannery* court would also find that there was a lack of substantial evidence that" they acted recklessly. *Flannery* held that the "thin materiality showing" could not support finding reckless conduct. In contrast, the evidence of materiality in this case is substantial: "By failing to provide the returns required by the Guidelines, Respondents denied potential clients information necessary to make informed

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63 *Flannery*, 810 F.3d at 11 n.8; *see also id.* at 10 n.3 (emphasizing that the slide at issue "was clearly labeled 'Typical Portfolio Characteristics—Limited Duration Bond Strategy' and did not purport to show the actual exposures to each sector at any given time"); *id.* at 10 (emphasizing that "the slide was clearly labeled 'Typical'").

64 Slip Op. at 19 (emphasis added).

65 *See Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38, 43-45 (2011) (emphasizing that materiality is weighed from the perspective of the "reasonable investor").

66 Slip Op. at 5, 18-19.

67 *Id.* at 23.

investment decisions, while representing that ZPRIM offered the benefits of GIPS compliance."[68] And the evidence in this case also demonstrated that Respondents acted not simply recklessly but also "intentionally" and "knowingly" in falsely claiming compliance with GIPS.[69] *Flannery* provides no basis for us to reconsider either the findings that Respondents' misrepresentations were material or that they acted with scienter.

Accordingly, IT IS ORDERED that ZPR Investment Management, Inc., and Max E. Zavanelli's motion for reconsideration is denied.

By the Commission.

Brent J. Fields
Secretary

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68 Slip Op. at 29.

69 *Id*. at 23, 25.