

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31560 / April 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16503

In the Matter of

**KORNITZER CAPITAL
MANAGEMENT, INC.
AND BARRY E. KOSTER,**

Respondents.

**ORDER INSTITUTING CEASE-
AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 9(f) OF
THE INVESTMENT COMPANY
ACT OF 1940, MAKING FINDINGS,
AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-
DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against Kornitzer Capital Management, Inc. (“KCM”) and Barry E. Koster (“Koster”) (collectively, “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds¹ that:

Summary

1. This proceeding relates to certain inaccurate and incomplete information furnished by a registered investment adviser, Kornitzer Capital Management, Inc., and its chief financial officer and chief compliance officer, Barry E. Koster, in connection with the process under Section 15(c) of the Investment Company Act by which KCM obtained the renewal of its advisory contracts with ten separate series of the Buffalo Funds (collectively, the "Funds"), all of which share a common board of trustees (the "Board").

2. Each year from 2010 through 2013 (the "Relevant Period"), the Board requested an analysis of KCM's profitability in managing the Funds, including an explanation of KCM's methodology for allocating its expenses, for purposes of this analysis, among the Funds and its other clients. Such information was reasonably necessary for the Board's evaluation of KCM's advisory contracts with the Funds. Koster, acting on behalf of KCM, prepared and provided to the Board the requested analysis and explanation of KCM's expense allocation methodology, which specifically represented that KCM allocated all employee compensation expenses to the Funds "based on estimated labor hours." In fact, in each year, Koster adjusted the allocation of the compensation of KCM's chief executive officer to the Funds in a manner designed, in part, to achieve consistency of KCM's reported profitability in managing the Funds year over year. Koster did not disclose this information to the Board. As a result, KCM failed to furnish information that was reasonably necessary for the Board to evaluate the terms of KCM's advisory contracts in violation of Section 15(c) of the Investment Company Act, and Koster caused KCM's violations.

Respondents

3. KCM, a Kansas corporation headquartered in Shawnee Mission, Kansas, has been registered as an investment adviser with the Commission since 1989. KCM has been the investment adviser to the Funds since their launch. It also acts as the adviser to separately managed private and institutional accounts and seventeen trust funds of an unregistered trust company. According to its most recently filed Form ADV, Part 2A, KCM manages accounts with combined assets under management of approximately \$11.3 billion.

¹ The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

4. Barry E. Koster, age 54 and a resident of Leawood, Kansas, has been the chief financial officer of KCM since 2002. In 2004, Koster became the chief compliance officer (“CCO”) of KCM and the Funds but relinquished his CCO role with both KCM and the Funds in April 2015.

Other Relevant Parties

5. The Buffalo Funds, a Delaware statutory trust with its principal place of business in Shawnee Mission, Kansas, has been registered with the Commission as an open-end investment company since 1994. Throughout the Relevant Period, the Buffalo Funds operated as a series trust with ten different series.

6. KCM’s chief executive officer (“the CEO”) is the majority owner of KCM and has been its president and CEO since he founded the company in 1989. During the relevant period, the CEO also served as KCM’s chief investment officer and the co-portfolio manager to one of the Funds.

Section 15(c) of the Investment Company Act and the Related Fund Filing Reports and Disclosures

7. Section 15(c) of the Investment Company Act makes it unlawful for a registered fund to enter into or renew any advisory contract unless the terms of the contract are approved by a majority of the fund’s independent directors. As part of the approval process, Section 15(c) imposes a duty on all directors to request and evaluate, and a duty on an adviser to furnish, such information as may reasonably be necessary for the directors to evaluate the terms of the adviser’s contract.

8. While Section 15(c) does not define what is “reasonably necessary” to evaluate a contract’s terms, the Commission has promulgated various fund filing disclosure requirements to better inform shareholders about a board’s evaluation process when approving or renewing an advisory contract. Specifically, in 2004, the Commission adopted form amendments, which replaced the previous statement of additional information requirements and required that when a fund board approves or renews any advisory contract, the fund’s next shareholder report must discuss, in reasonable detail, the material factors and conclusions with respect thereto that formed the basis for the directors’ approval or renewal of that contract. See Disclosure Regarding the Approval of Investment Advisory Contracts by Directors of Investment Companies, Investment Company Act Release No. 26486 (June 30, 2004).

9. As to the approval or renewal of an advisory contract, funds must include a discussion in their shareholder reports concerning, among other things, the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the fund. See Form N-1A, Item 27(d)(6)(i). As noted by the Commission, “[i]t would be difficult for a board to reach a final conclusion as to whether to approve an advisory contract without reaching conclusions as to each material factor.” Investment Company Act Release No. 26486 (Emphasis added).

Facts

The Board's Section 15(c) Request Regarding KCM's Profitability for Managing the Funds

10. During the Relevant Period, the Board considered the renewal of KCM's advisory contracts with each Fund at the Board's November board meeting. In advance of each of those board meetings, the Board requested certain information from KCM for the Board's consideration of KCM's advisory contracts, including an "[a]nalysis of the profitability of each Fund to the Adviser over the past two years, including expenses related to services provided to each Fund, with an explanation of the expense allocation methodology." KCM's profitability analysis was reasonably necessary for the Board's consideration of KCM's advisory contracts under Section 15(c) of the Investment Company Act.

11. Indeed, as described in the Buffalo Funds' shareholder reports during the Relevant Period, the Board considered KCM's costs of services to be provided and profits to be realized from its management of the Funds in determining whether to renew KCM's advisory contracts. For example, the Buffalo Funds' March 31, 2012 Annual Report disclosed, in relevant part, that "[t]he Trustees also examined the level of profits that could be expected to accrue to the Adviser from the fees payable under the Agreements...[and] concluded that the Adviser's profit from sponsoring the Funds had not been and would not be excessive and would enable the Adviser to maintain adequate profit levels to support its provision of advisory services to the Funds."

KCM's Profitability Analyses and Disclosures of Its Expense Allocation Methodology

12. During the Relevant Period and in response to the Board's requests, KCM provided the Board with a one-page analysis of its profitability in managing the Funds for its latest two fiscal years.² KCM's profitability analysis included line items for, among other things: total revenue; total operating expenses; net operating income before income taxes; and net income before income taxes.

13. KCM's only revenue from the Funds was the investment advisory fees it earned from managing the Funds, which required no estimation. However, because KCM also served as the investment adviser to other clients, only a portion of its total operating expenses were attributable to services provided to the Funds for purposes of analyzing KCM's profitability with respect to the Fund's advisory contracts. Therefore, and per the

² Each year during the Relevant Period, KCM prepared its financial statements using fiscal years ending on March 31. Throughout the Relevant Period, KCM's profitability analysis used its financial results for its two most recent fiscal years ended March 31 for the Board's consideration of advisory contract renewal in November of that year. For example, for the Board's consideration of advisory contract renewal in November 2012, KCM provided profitability analysis for its fiscal year ended March 31, 2011 and March 31, 2012.

Board's request, KCM's profitability analysis also included an explanation of its methodologies for allocating various expenses, for purposes of this analysis, to the Funds.

14. With respect to KCM's allocation of employee compensation, for 2010, 2011, and 2012, KCM represented as follows: "salaries and benefits – allocated based on estimated labor hours." KCM's profitability analysis for 2013 repeated that disclosure, but also specified that KCM allocated the CEO's compensation based on a "percentage (estimate) of time working on the Buffalo Funds and intangible value to the Buffalo Funds based on leadership, decision making and management responsibilities."

Adjustment of the Allocation of the CEO's Compensation Expenses to KCM's Management of the Funds

15. During the Relevant Period, Koster was responsible for preparing KCM's profitability analysis and the explanation of its expense allocation methodology. Koster was also responsible for determining how much of each KCM employee's total compensation to allocate to the Funds.

16. Employee compensation constituted KCM's largest expense allocated to its management of the Funds during the Relevant Period. For example, in fiscal year 2013, employee compensation made up approximately 87% of KCM's total operating expenses. During the Relevant Period, the compensation expense of the CEO made up a significant portion of KCM's reported operating expenses in managing the Funds.

17. Contrary to what KCM had stated in its profitability analyses furnished to the Board, each year during the Relevant Period, Koster did not allocate the CEO's compensation to the Funds based solely upon the CEO's estimated labor hours, but also took into account other factors. Specifically, each year, Koster:

- a. Reviewed KCM's total revenue, total operating expenses, and reported profitability from the prior fiscal year;
- b. Considered KCM's revenue growth in the latest fiscal year;
- c. Considered what profit margin would result from the proposed allocation of the CEO's compensation; and then
- d. Allocated a percentage of the CEO's compensation to the Funds in a manner in part designed to achieve consistency of KCM's reported profitability in managing the Funds.

18. Among other things, Koster sought to portray that KCM maintained consistent pre-tax net profit margins from year to year. As indicated in paragraph 12, above, KCM's profitability analysis for each year included line items for total revenue and net operating income before income taxes. As described herein, the pre-tax net profit margin is equal to the net operating income before income taxes divided by total revenue.

19. For KCM’s fiscal years 2010 through 2012, KCM’s total revenue from managing the Funds increased each year from approximately \$22.6 million, to \$31 million, to \$34.1 million, respectively. In those same years, Koster likewise increased the percentage of the CEO’s compensation allocated to the Funds from 35%, to 40%, to 49.5%, respectively. By doing so, KCM reported almost identical pre-tax net profit margins year over year as follows:

KCM’s Fiscal Year-End	KCM’s Total Revenue from Managing the Funds	Percentage of CEO’s Compensation Allocated to the Funds	KCM’s Reported Pre-Tax Net Profit Margin
2010	\$22,654,560	35%	28.1%
2011	\$31,017,648	40%	26.9%
2012	\$34,138,538	49.5%	26.8%

20. In KCM’s fiscal year 2013, its total revenue for managing the Funds increased by more than 11% to approximately \$38 million. Also in that fiscal year, the CEO’s compensation increased by more than 70% from the prior year. In part, in order to avoid showing a significant reduction in KCM’s profitability, Koster allocated just 25% of the CEO’s compensation to managing the Funds, which resulted in a reported pre-tax net profit margin of approximately 40%.

21. During the Relevant Period, KCM did not disclose to the Board that Koster considered other factors beyond estimated labor hours in allocating CEO compensation expense or that Koster adjusted the percentage of the CEO’s compensation allocated to the Funds in part in order to maintain the consistency of KCM’s reported profitability.

22. For each year during the Relevant Period, Koster’s adjustment to the allocation of the CEO’s compensation to the Funds caused information concerning KCM’s reported profitability in managing the Funds to be inaccurate and incomplete.

23. During the Relevant Period, information regarding KCM’s profitability, including the metrics described in paragraph 12, above, and KCM’s methodology for allocating employee compensation expenses to the Funds, was reasonably necessary for the Board to evaluate the terms and renewal of the advisory contracts between KCM and the Funds. In particular, this information was reasonably necessary for the Board’s determination that KCM’s profitability in managing the Funds had not been and would not be excessive and would enable KCM to maintain adequate profit levels to support its provision of advisory services to the Funds.

Violations

24. As a result of the conduct described above, KCM violated Section 15(c) of the Investment Company Act, which makes it the duty of an investment adviser to a registered investment company to furnish such information as may reasonably be necessary for the investment company's directors to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser to such company.

25. As a result of the conduct described above, Koster caused KCM's violations of Section 15(c) of the Investment Company Act.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents KCM and Koster cease and desist from committing or causing any violations and any future violations of Section 15(c) of the Investment Company Act;

B. Respondents KCM and Koster shall, within 10 days of the entry of this Order, pay a civil money penalty in the amounts of \$50,000 and \$25,000, respectively, to the Securities and Exchange Commission. If timely payments are not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent's name as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kurt L. Gottschall, Assistant Regional Director, Asset Management Unit, Denver Regional Office,

U.S. Securities and Exchange Commission, Byron G. Rogers Federal Building, 1961 Stout Street, Suite 1700, Denver, CO 80294.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent Koster, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Koster under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Koster of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary